



MORNING BRIEFING

September 13, 2021

Not So Transitory After All?

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

(1) Raising S&P 500 EPS by \$5 per year through 2023. (2) Five quarterly earnings hooks in a row. (3) Forward earnings at another record high. (4) A long worry list is traditional this time of year. (5) No sign of a peak in August's PPI. (6) Three broad measures of consumer prices aren't pretty. (7) Almost \$1.5 trillion in reverse repos at the Fed. (8) Bonds are awash in liquidity. (9) Fund flows contradict TINA. (10) Drilling down into the PPI rabbit hole.

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

Strategy I: Raising Our Earnings Forecasts. Industry analysts continue to raise their earnings estimates for 2021, 2022, and 2023. Joe and I are doing the same. The difference is that their consensus estimates change on a weekly basis, while ours do quarterly, as Joe and I usually adjust them after earnings-reporting seasons. We are raising our S&P 500 earnings-per-share estimates for this year, next year, and the following year by \$5 each and sticking with our estimates for S&P 500 revenues.

Here are our latest estimates for S&P 500 revenues, earnings, and profit margins:

(1) *Revenues*: 2021 (\$1,600), 2022 (1,650), and 2023 (1,700) ([Fig. 1](#)).

(2) *Earnings*: 2021 (\$210), 2022 (220), and 2023 (235) ([Fig. 2](#)).

(3) *Margins*: 2021 (13.1%), 2022 (13.3), and 2023 (13.8) ([Fig. 3](#)).

Now all we have left to do before we take the rest of the day off is to forecast forward earnings and the forward P/E to calculate our S&P 500 targets:

(4) *Forward Earnings*: 2021 (\$220), 2022 (235), and 2023 (250) ([Fig. 4](#)).

(5) *Forward P/E*: 2021 (22.0), 2022 (22.0), and 2023 (22.0) ([Fig. 5](#)).

(6) *S&P 500 Target: 2021 (4800), 2022 (5200), and 2023 (5500)* ([Fig. 6](#)).

The Q2 earnings season was the fifth in a row in which results were much better than consensus forecasts ([Fig. 7](#)). As a result, industry analysts have been raising their estimates for the remaining two quarters of this year and all four of next year ([Fig. 8](#)). As of the week of September 2, they were projecting earnings to be \$201.04 this year and \$220.35 next year ([Fig. 9](#)).

Forward earnings, the time-weighted average of the consensus estimates for this year and next year, rose to a record high of \$214.04 per share during the September 2 week. (See [YRI S&P 500 Earnings Forecast](#). For a thorough primer on forward earnings, see [S&P 500 Earnings, Valuation & the Pandemic](#).)

Strategy II: Inflation vs Bond Yields. At the end of last week, the S&P 500 was down just 1.7% from its record high of 4536.95 on September 2. That's impressive considering the long list of current worries: Inflation has yet to show signs of peaking. The Fed is expected to start tapering before the end of this year. The ECB has already started to taper. The Democrats are pushing trillion-dollar spending programs along with trillion-dollar tax proposals through Congress. The debt ceiling has to be raised so that the Treasury can pay the bills. Parts shortages are forcing companies to scale back their production. There are geopolitical risks. September and October tend to be bad months for stocks. And oh yeah, the pandemic is still out there.

Inflation should be a major concern, yet the bond yield remains subdued around 1.30%. Friday's PPI should have unsettled the bond market, but it didn't do so. Also subdued has been the forward P/E of the S&P 500. It has remained elevated around 22.0 since the second half of 2020. Equity and bond markets remain unperturbed by the latest signs that inflation is still heating up rather than cooling off. Consider the following:

(1) *PPI might be a warm-up act for CPI.* The PPI bottomed last year at -1.5% y/y during April ([Fig. 10](#)). So the base effect on inflation should be diminishing in the August data. Yet there was no sign of a peak in this series during August, when it rose to 8.3%, with the goods component up 12.6% and the services component up 6.4%.

The CPI and PCED inflation rates track the PPI for personal consumption closely ([Fig. 11](#)). The bad news is that the latter was up 7.4% during August, suggesting that July's 5.4% and 4.2% increases in the CPI and PCED rose even more last month.

The only good news we can find on the inflation front is that the prices-paid indexes of the national M-PMI and NM-PMI seem to have peaked during June and July, respectively ([Fig. 12](#)). The average of the two is down from 85.8 during June to 77.4 during August.

(2) *The Fed is still replenishing the punch bowl.* So why doesn't the bond market care? Where oh where are the Bond Vigilantes? They've been drowned by all the liquidity provided by the Fed. Tapering, if and when it happens, initially will only slow the pace at which the Fed is filling the punchbowl, not stop their pouring. For now, it continues to overflow.

We can see that in the widening divergence between commercial bank deposits, which rose to a record high at the end of August, and bank loans, which are no higher now than they were before the pandemic ([Fig. 13](#)). The Fed's bond purchases have boosted bank deposits, while the Fed's zero-interest-rate policy has allowed companies to borrow at record-low yields in the bond market. Banks have put the surplus cash mostly into Treasury and agency securities. The banks along with other financial intermediaries have also been pouring their cash into reverse repos at the Fed, which totaled a record \$1.40 trillion during the week of September 1 ([Fig. 14](#)).

(3) *Fund inflows are a plus.* Meanwhile, the 12-month sum of net inflows into equity mutual funds and ETFs turned positive during June and July for the first time since early 2019 ([Fig. 15](#)). Over the 12 months through July, equity ETFs had net inflows totaling \$594 billion, while equity mutual funds had net outflows of \$468 billion.

By the way, there is actually a very simple explanation for why the 10-year Treasury bond yield peaked at 1.74% on March 31 of this year and fell to a recent low of 1.19% on August 4, closing at 1.35% on Friday. On a 12-month basis, net inflows into bond mutual funds and ETFs soared from \$572 billion during January to peak at a record \$1.01 trillion during April ([Fig. 16](#)). It remained substantial at \$861 billion through July. Contrary to TINA ("there is no alternative" to equities), bonds are still viewed by some investors as an alternative to stocks!

That's on top of the \$1.6 trillion of US Treasury and agency bonds purchased by the Fed and the commercial banks from the start of this year through late August ([Fig. 17](#)).

(4) *Blue Angels and valuation.* All this liquidity certainly helps to explain why the forward P/E of the S&P 500 has been remarkably stable over the past year at a relatively high level. That stability has allowed the S&P 500 to melt up along with forward earnings since last summer, as we can see in our Blue Angels framework ([Fig. 18](#)).

Inflation I: More of It. Debbie and I are starting to worry that inflation may not be as transitory as Fed Chair Jerome Powell has been claiming it will be. As she discusses below, the PPI for final demand of both goods and services rose 0.7% m/m and 8.3% y/y during August, the most since 12-month data were first calculated in November 2010. The three-month annualized increase was 10.6% ([Fig. 19](#)). Here are some details on the PPI for final demand for goods (PPI-FD-G) and services (PPI-FD-S):

(1) *Goods*. The PPI-FD-G rose 1.0% m/m. Half of the broad-based advance in August can be attributed to a 2.9% rise in prices for final demand foods, with about a quarter of the August advance attributable to an 8.5% rise in the index for meats. Prices for residential natural gas, industrial chemicals, processed young chickens, motor vehicles, and steel mill products also moved higher.

(2) *Services*. The PPI-FD-S moved up 0.7% in August. Two-thirds of the broad-based increase in August can be traced to the 1.5% increase in the index for final demand trade services, which measures changes in the margins received by wholesalers and retailers. Prices for final demand transportation and warehousing services climbed 2.8% m/m and 15.8% y/y ([Fig. 20](#)). Excluding these items, the overall services PPI was up just 0.1% m/m, but still up 4.6% y/y.

(3) *Bottom line*. There really is no sign yet that inflation is transitory. This will put more pressure on Fed officials to start tapering soon just in case they have to raise interest rates sooner than they expected.

Mark September 22 on your calendar. That's the day when the FOMC will release its latest "Summary of Economic Projections" (SEP). We expect that at least 10 of the participants will project a rate increase next year, up from seven in June's dot plot. We also expect that the median inflation forecast will be raised for 2021. It was 3.4% in June's SEP, up from 2.4% in March.

Inflation II: More on It. The Bureau of Labor Statistics (BLS) has been compiling the Producer Price Index (PPI) since 1947. Prior to January 2014, the PPI was based on stage-of-processing (SOP) and limited to finished, intermediate, and crude goods. Since then, the BLS has expanded coverage beyond that of the SOP system through the addition of services, construction, exports, and government purchases. BLS refers to this as the Final Demand–Intermediate Demand (FD–ID) system.

As a result of FD-ID, the PPI now includes indexes for personal consumption, which reflect the prices of marketable output sold by producers to consumers. The CPI includes prices paid by consumers. So the “C-PPI” excludes rent and prices of imports. The C-PPI excludes taxes, while the CPI includes sales taxes paid by consumers.

Since July 2009, the PPI has also included commodity indexes for services and construction in addition to raw materials.

For more information, see the [article](#) titled “Comparing new final demand producer price indexes with other Government price indexes” in the BLS’s *Monthly Labor Review*, dated January 2014.

Calendars

US: Mon: Federal Budget Balance, -\$173.0b, OPEC Monthly Report. **Tues:** Headline & Core CPI 5.3%/4.2% y/y, NFIB Small Business Optimism. (Bloomberg estimates)

Global: Mon: China New Loans. **Tues:** UK Employment Change & Unemployment Rate 75k/4.6%, UK Average Earnings Including & Excluding Bonus 8.2%/6.8% y/y, Spain CPI 0.4% m/m/3.3% y/y, Japan Industrial Production, Japan Core Machinery Orders 3.1% m/m/15.7% y/y, China Industrial Production 5.8% y/y, China Retail Sales 7.1% y/y, China Fixed Asset Investment 9.1% y/y. (Bloomberg estimates)

Strategy Indicators

Global Stock Markets Performance ([link](#)): Last week saw the US MSCI index fall 1.7% in its biggest decline since late February and end the week 1.7% below its record high on September 6. The US ranked 29th of the 49 global stock markets that we follow in a week when just eight of the 49 countries rose in US dollar terms. The AC World ex-US index performed better, falling just 0.5% to 1.6% below its September 15 record high as nearly all regions fell. EMEA and BRIC were the best-performing regions last week with gains of 0.2%, ahead of EM Asia (-0.3%) and EAFE (-0.3). EM Latin America was the biggest underperformer with a decline of 2.7%, followed by EMU (-1.2) and EM Eastern Europe (-0.7). Japan was the best-performing country last week, with a gain of 3.5%, followed by the

Philippines (1.1), Hong Kong (1.1), China (0.9), and Hungary (0.7). Pakistan was the worst performer with a decline of 4.9%, followed by Turkey (-4.0), South Africa (-3.9), and Portugal (-3.7). EMEA is the top-performing region ytd, with a gain of 22.8%, ahead of EM Eastern Europe (21.5), the United States (18.3), EMU (13.4), and EAFE (10.9), and the AC World ex-US (8.4). The following regions are lagging the AC World ex-US: BRIC (-3.2), EM Latin America (-2.2), and EM Asia (-0.7). The top-performing countries ytd: Argentina (38.6), the Netherlands (34.1), the Czech Republic (30.5), Austria (29.8), and Hungary (29.6). The biggest laggards of 2021 so far: Peru (-27.9), Pakistan (-21.7), Colombia (-17.0), Turkey (-15.2), and Sri Lanka (-14.1).

S&P 1500/500/400/600 Performance ([link](#)): LargeCap fell 1.7% last week, less than the 2.7% and 3.1% declines for MidCap and SmallCap, respectively. LargeCap ended the week 1.7% below its record high on September 2, while MidCap and SmallCap finished 3.1% and 6.2% below their respective record highs on September 2 and June 8. All 33 sectors were lower for the week, down from 21 sectors rising a week earlier. LargeCap Consumer Discretionary was the best performer of the week, albeit with a decline of 0.3% followed by SmallCap Energy (-0.7), LargeCap Communication Services (-1.2), LargeCap Consumer Staples (-1.3), and LargeCap Financials (-1.3). SmallCap Real Estate was the worst performer with a decline of 4.8%, followed by MidCap Real Estate (-4.0), MidCap Consumer Staples (-3.9), LargeCap Real Estate (-3.9), and SmallCap Consumer Discretionary (-3.6). LargeCap edged back into the lead in the 2021 derby with a gain of 18.7% ytd, ahead of SmallCap (18.6), and MidCap (16.5). All 33 sectors are higher ytd, paced by these best sector performers: SmallCap Energy (50.9), MidCap Energy (45.4), SmallCap Consumer Discretionary (33.3), LargeCap Real Estate (28.4), and LargeCap Communication Services (27.7). The biggest laggards so far in 2021: MidCap Consumer Staples (2.2), MidCap Communication Services (2.3), LargeCap Consumer Staples (7.0), MidCap Tech (7.0), and LargeCap Utilities (8.4).

S&P 500 Sectors and Industries Performance ([link](#)): All 11 S&P 500 sectors fell last week and six outperformed or matched the composite index's 1.7% decline. That compares to a 0.6% gain for the S&P 500 a week earlier, when seven sectors rose and seven outperformed the index. Consumer Discretionary was the best performer, albeit with a decline of 0.3%, ahead of Communication Services (-1.2%), Consumer Staples (-1.3), Financials (-1.3), Utilities (-1.6), and Materials (-1.7). The worst performers this week: Real Estate (-3.9), Health Care (-2.7), Industrials (-2.5), Energy (-1.8), and Tech (-1.8). With respect to 2021's performance, the S&P 500 has risen 18.7% so far, with all 11 sectors higher ytd and five beating the broader index. Real Estate is the leading sector with a gain of 28.4% ytd, followed by Communication Services (27.7), Financials (27.1), Energy (24.9),

and Tech (19.9). This year's laggards to date, albeit with gains: Consumer Staples (7.0), Utilities (8.4), Consumer Discretionary (12.2), Industrials (14.7), Materials (15.4), and Health Care (17.0).

S&P 500 Technical Indicators ([link](#)): The S&P 500 fell 1.7% 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 12th week after dropping below for a week in mid-June for the first time since February. It was above its 200-dma for a 63rd 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 44th straight week as the price index dropped to an eight-week low of 0.7% above its rising 50-dma from 2.9% 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 63rd week last week, but dropped to an eight-week low of 8.8% above its rising 200-dma from 11.3% a week earlier. It had been at a four-month low of 8.0% in early March. 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 of the 11 S&P 500 sectors traded above their 50-dmas last week, down from ten a week earlier as Industrials fell below. The other laggard, Energy, was below for a tenth straight week. That compares to all 11 sectors above at the beginning of May and just four above at the end of January. Nine sectors have a rising 50-dma, also down from ten a week earlier. Industrials joined Energy in the latest week as the only sectors in the falling 50-dma doghouse. Looking at the more stable longer-term 200-dmas, ten sectors are above compared to all 11 a week earlier, as the Energy sector fell below yet again. However, all 11 sectors have had rising 200-dmas for 26 straight weeks. For perspective, back in April 2020, just one sector (Health Care) was trading above its 200-dma. Energy's 200-dma had finally turned higher in mid-December after mostly falling since October 2018.

US Economic Indicators

Producer Price Index ([link](#)): The Producer Price Index for final demand—total final demand as well as both its goods and services components—continued to climb to new record highs for yearly inflation rates in August. Final demand prices rose 0.7% after back-to-back gains of 1.0%, with monthly increases for final demand goods (to 1.0% from 0.6%) accelerating during the month and those for final demand services (0.7 from 1.1) decelerating a bit, though both posted notable gains. On a three-month-percent-change basis, total final demand along with final demand for both goods and services posted double-digit gains of 10.6%, 11.2%, and 10.3% (saar), respectively, during August—pushing the yearly percent changes of all three to new record highs of 8.3%, 12.6%, and 6.4%. Meanwhile, final demand prices excluding food, energy, and trade services rose 0.3% last month, one-third July's 0.9% rate—though still recorded a record 6.3% y/y rate. In the meantime, yearly rates for pipeline prices remain very high, with the yearly rate for intermediate goods prices continuing to accelerate last month—up 23.0% y/y, the highest since the mid-1970s—while the rate for crude prices rose a sharp 50.1% y/y, though eased from April's 59.4% record high.

Global Economic Indicators

UK GDP ([link](#)): The UK recovery stalled in July, with real GDP edging up at a six-month low of only 0.1%, despite the removal of most pandemic restrictions, as “pingdemic” shortages kept many workers at home. These shortages reflect those workers “pinged” by NHS Test & Trace, notifying them that they need to self-isolate after being in close contact with someone who has tested positive for Covid-19. The service sector, which accounts for roughly 80% of the UK economy, was flat in July, as a 2.5% drop in retail sales offset growth in outdoor events—with the service sector 2.1% below its pre-pandemic level. Production industries, which include manufacturing, advanced 1.2% in July, boosted by the reopening of an oil field production site, which was temporarily closed for planned maintenance. Meanwhile, manufacturing activity was flat in July after five months of gains, reflecting staff and supply-chain shortages. Construction output contracted for the fourth successive month, by 1.6% in July and 3.7% over the period.

UK Industrial Production ([link](#)): Output advanced 1.2% in July, boosted by a 22.0% surge in mining & quarrying following a maintenance closure, placing headline production within 2.0% of its pre-Covid level. Meanwhile, manufacturing production was flat in July, following

little growth the prior three months; output had jumped 2.6% during the two months through March. Looking at the main industrial groups, consumer durable goods production has rebounded 5.2% during the two months ending July, to within a tick of its pre-Covid level, while intermediate goods production remains in a flat trend above its pre-pandemic reading. Consumer nondurable goods output jumped 6.9% in May, a new record high, though fell 3.3% in June before flattening out in July.

France Industrial Production ([link](#)): Headline production, which excludes construction, advanced 0.3% in July, half of June's 0.6% increase, which followed May's 0.3% downtick. Production has shown little growth on a year-to-date basis, after starting the year with a 3.5% increase and a 4.6% decrease the first two months of the year. Among the main industrial groupings, output is in the black ytd for only consumer nondurable goods (+4.6%) and energy (+0.8), while capital (-2.0) and intermediate goods (-1.0) production are in the red, with consumer durable goods (-0.2) production basically flat. Looking ahead, IHS Markit's M-PMI (57.5) slowed to a six-month low in August, though remained at a robust reading. The report noted that "immense supply-side challenges" are causing a production slowdown, though there are also backlogs of work accumulating "at some hefty rates," suggesting there is sufficient work in the wings to keep production at a solid rate.

Italy Industrial Production ([link](#)): Italy's industrial production increased in July for the sixth time this year, up 0.8% m/m and 4.0% ytd, surpassing its pre-Covid level by 1.5%. This year to date, only consumer durable goods production (-0.6%) showed a decline, and a slight one at that, while consumer nondurable, intermediate, and capital goods production expanded 6.7%, 4.2%, and 3.7%, respectively. Intermediate (+6.1%) and consumer durable (+3.2%) goods production are both above their pre-Covid levels—the latter despite its recent weakness. Meanwhile, capital and consumer nondurable goods production are within 1.1% and 2.6%, respectively, of their pre-Covid readings. August's IHS Markit M-PMI suggests further improvement up ahead, rising to 60.9—the third-highest reading on record (behind only May and June)—as growth in both orders and production has accelerated.

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