MORNING BRIEFING
September 28, 2021

Some Good News, Some Bad News

Check out the accompanying chart collection.

(1) Cresting pandemic wave. (2) Back to pre-pandemic railcar loadings. (3) Ford is parking lots of unfinished trucks at Kentucky Speedway. (4) Record new orders with usual lag in shipments. (5) Q3 real GDP tracking at 3.2%. (6) Europe is providing a cautionary tale on outlook for energy availability and pricing. (7) Chevron's CEO implies climate activists interfering with market signals. (8) President Xi facing two crises.

Good News I: Pandemic Wave Cresting. In the US, the third wave of the pandemic seems to be cresting (*Fig. 1*). The 10-day moving average of new positive Covid results is down 35% from its recent peak on September 3 through September 24. The number of Covid hospital patients is looking toppy as well. However, Covid-related deaths are still rising, though remain well below the record high earlier this year (*Fig. 2*). As of September 24, 81% of Americans 16 years old and older had at least one dose of a Covid vaccine (*Fig. 3*).

Good News II: Economy Growing. The US economy continues to perform well even though the pandemic clearly isn't over. The TSA checkpoint travel numbers at US airports are back near pre-pandemic readings (*Fig. 4*). Railcar loadings excluding coal are back at pre-pandemic levels as well, and so are intermodal loadings (*Fig. 5*).

On the other hand, loadings of motor vehicles are down in recent weeks because auto manufacturers are experiencing parts shortages (*Fig. 6*). Ford is still making trucks; it's just making them without the necessary parts, holding them until the chips finally come in, and then shipping them out to dealers. Ford is doing this with what looks like thousands of vehicles. *The Drive* obtained satellite images of Kentucky Speedway, which show thousands of trucks at the facility awaiting chips.

Yesterday's durable goods orders release for August was strong again, as Debbie discusses below. Nondefense capital goods orders excluding aircraft rose 0.5% m/m and 13.7% y/y to yet another record high (*Fig. 7*). Shipments are lagging orders as they typically do. In other words, it's hard to see the disruption caused by parts shortages in the relationship between orders and shipments.

During Q2, real GDP exceeded its pre-pandemic level (*Fig. 8*). After rising by over 6.0% (saar) during Q1 and Q2, it is likely to settle down to between 3.0% and 4.0% growth during the second half of this year, more in line with its underlying long-term trend. The Atlanta Fed's *GDPNow* model estimate for real GDP growth during Q3-2021 was 3.2% on September 27.

Bad News I: Winter Is Coming. Be warned: As the character Eddard Stark said in the HBO's *Game of Thrones*, "Winter is coming." The mad rush to stop climate change by going cold turkey on fossil fuels could leave lots of people out in the cold this winter. Greta Thunberg and other climate change activists are succeeding in pushing their agenda to get us off our addiction to fossil fuels. This is causing major withdrawal pains since alternative sources of energy are turning out to have some significant disadvantages. Consider the following:

(1) Wind turbines don't work when the wind stops blowing. Last Thursday, Jackie and I wrote: "The UK has noble intentions of cutting its carbon footprint by turning to electricity generated by windmills and by closing all coal plants by late 2024. Wind power represented about a quarter of the power used by Great Britain last year. But the wind in the North Sea unexpectedly dropped dramatically in September, reducing related electricity production, a September 13 *WSJ* *article* reported. The shortfall of wind-generated electricity has forced a return to gas- and coal-fired electricity plants."

(2) Gas prices are soaring in Europe, boosting inflation and depressing economic growth. European gas prices are up almost 500% in the year. At their peak, UK electricity prices more than doubled in September and were almost seven times as high as at the same point in 2020. Power prices also have jumped in France, the Netherlands, and Germany (*Fig. 9*). The price surge shows the need to have backup power supplies for when the wind doesn't blow and the sun doesn't shine.

(3) The biggest industrial energy users of electricity are particularly hard hit by the price spike. Zinc producer Nyrstar NV said on Thursday it is cutting output at a major Dutch plant during peak times of day. A major fertilizer maker was forced to shut down two UK plants as a result of the soaring natural gas price. A shortage of fertilizer could boost food prices. High energy prices could put inflationary pressures on other costs, which will end up being passed on to customers.

(4) A September 27 Bloomberg *article* concluded: "The crisis in Europe presages trouble for

the rest of the planet as the continent's energy shortage has governments warning of blackouts and factories being forced to shut."

(5) Under pressure from the activists, the major oil companies are limiting their spending on new oil and gas supplies. On September 15, in an interview with Bloomberg News, Chevron's Chief Executive Officer Mike Wirth predicted that energy prices will remain high for the foreseeable future because oil and gas producers are hesitant to drill for more oil and gas. He didn't say it explicitly, but his remarks implied that climate change activists are "interfering with market signals."

The oil and gas industry obviously has been affected by two of this year's major events: A Dutch court earlier this year ordered Royal Dutch Shell to reduce carbon emissions by 45% by 2030. And Exxon Mobil was forced to backtrack on an aggressive expansion plan as climate change activists succeeded in adding two board members.

Wirth concluded with a question that sounded rhetorical to me: "Looking out for a few years if the global economy continues to grow and recover post Covid, is there sufficient reinvestment in the energy that runs the world today? Or are we turning so quickly to the energy that runs tomorrow that we created an issue in the short term?"

(6) Alternative renewable sources of energy aren't coming on stream fast enough to replace the deficit between demand and supply, and they aren't reliable, especially when we need them like during the winter. And don't forget: Winter is coming.

Bad News II: Credit Crunch & Energy Crises in China. In the US, most recessions have been caused either by credit crunches, energy crises, or both. Jackie and I are seeing more signs of both crises unfolding in China. President Xi Jinping soon may have to borrow a phrase from *Hamlet*: "When sorrows come, they come not single spies but in battalions." In addition to a debt crisis in the real estate sector, China is developing an energy crisis. Consider the following:

(1) A September 25 Bloomberg *article* is provocatively titled "Why China's Evergrande Crisis Could Be Worse Than the U.S. Crash." It notes that "[r]eal estate and related industries account for almost 30% of China's GDP—a far higher share than the U.S. at the height of its boom." It also reports that the homeownership rate is 90%, and it's estimated that urban Chinese people have more than 70% of their net worth in property. If Xi is really set on taking air out of China's property bubble by reducing the availability of credit to developers and making housing more affordable, lots of his citizens will be very unhappy.

(2) A September 20 Bloomberg *article* reported, “China is planning to expand air pollution curbs in Beijing and nearby provinces to more cities that are crucial for the production of coal, steel and transport fuel. The move comes as President Xi Jinping tries to ensure blue skies for the Winter Olympics to be held in and around the Chinese capital in February, and are on top of national efforts to reduce carbon emissions and control power usage to improve efficiency and avoid crunches.”

(3) Some northern provinces have ordered industrial cuts in order to meet emissions and energy intensity goals, while others are facing an actual lack of electricity amid high demand. Residents in several of these provinces have been experiencing blackouts. The September 26 Bloomberg *reported*, “Power rationing has spread across many of China’s economic powerhouse provinces as local governments risk missing targets for reducing the emissions intensity of their economies, with smelters in Yunnan, textile plants in Zhejiang and soybean crushers in Tianjin all reported to have halted to prevent power cuts to non-industrial users.”

(4) During August, China’s PPI inflation rate was 9.5% y/y, the highest since September 2008 (*Fig. 10*). The PPI for coal is up 57.1% (*Fig. 11*). The CPI was up only 0.8% over the same period. It was held down by meat prices, which fell 27.1% (*Fig. 12*). However, the CPI for fuel and power was up 26.2% (*Fig. 13*).

Calendars

US: Tues: Consumer Confidence 114.5, Goods Trade Balance, Richmond Fed Manufacturing Index, Retail & Wholesale Inventories, S&P HPI Composite 1.6%m/m/20.0%y/y, Weekly Crude Oil Inventories, Evans, Bostic. **Wed:** Pending Home Sales 1.3%, MBA Mortgage Applications, Crude Oil Inventories, Powell, Bostic. (Bloomberg estimates)

Global: Tues: Germany Gfk Consumer Climate Index, France Consumer Confidence 100, Japan CPI, Lagarde. **Wed:** Eurozone Business & Consumer Survey 116.7, Germany Retail Sales 1.3%, Spain CPI 3.3% y/y, Japan Industrial Production -0.5%, Japan Retail Sales -1.0% y/y, China Official & IHS Markit M-PMIs 49.6/50.2, Lagarde, Lane, Bailey, Kuroda. (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. LargeCap's dropped a hair below its record high a week earlier due to Match's addition to the index. MidCap's was at a record high for a 33rd straight week, and SmallCap's was at a record for a third week after dropping a week earlier 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 68 of the past 71 weeks, with the two other down weeks due to Tesla's addition to the index last December and Amazon's earnings shortfall in August. MidCap's is up in 67 of the past 69 weeks, and SmallCap's posted 66 gains in the past 70 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 52.3% from its lowest level since August 2017; MidCap's is now up 99.5% from its lowest level since May 2015; and SmallCap's has soared 157.2% 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 36.4%, 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 fell w/w to 61.4% y/y from 65.3%. 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 dropped to 95.0% from 96.7%; 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 (43.7%, 9.6%), MidCap (74.6, 7.0), and SmallCap (112.6, 13.7).

S&P 500/400/600 Valuation (*link*): Valuations mostly ticked higher last week for these three indexes. LargeCap's forward P/E rose 0.1pt w/w to 20.7 from an 11-month low of 20.6. 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 was steady at a 17-month low of 16.3. That compares to a seven-month high of 20.5 in early March and is 6.5pts below its record high of 22.9 in June 2020. SmallCap's rose 0.1pt to 15.5 from a 17-month low of 15.4. It's now down 11.2pts 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 51st week. That's the longest stretch at a discount since 2002-03; SmallCap's current 25% reading is near 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 15th straight week; SmallCap's current 5% discount to MidCap's 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 Q3-2021 blended earnings-per-share estimate ticked down 17 cents w/w to $48.97. That $48.97 estimate for Q2-2021 represents a gain of 26.6% y/y on a frozen actual basis and a 29.6% y/y gain on a pro forma basis. That would mark a third straight quarter of double-digit percentage growth and compares to a pro forma gain of 96.3% in Q2-2021. All 11 sectors are again expected to post positive y/y earnings growth during Q3-2021. Here are the S&P 500 sectors' latest expected earnings growth rates for Q3-2021 versus their final Q2-2021 growth rates: Energy (1,390.4% in Q3-2021 versus 243.3% in Q2-2021), Materials (93.4, 139.5), Industrials (81.6, 698.4), S&P 500 (29.6, 96.3), Information Technology (28.6, 49.6), Communication Services (23.8, 72.8), Financials (17.6, 158.2), Real Estate (17.5, 38.7), Health Care (15.1, 27.2), Consumer Discretionary (9.5, 380.5), Consumer Staples (3.2, 20.4), and Utilities (0.2, 12.6).

US Economic Indicators

Durable Goods Orders & Shipments (*link*): Both core capital goods orders and shipments continued to set new record highs yet again in August. Nondefense capital goods orders ex aircraft (a proxy for future business investment) has increased every month but one since bottoming last April, climbing 0.5% in August and 28.7% over the 16-month period. Core capital goods shipments (used in calculating GDP) climbed for the 15th time since last April's bottom, up 0.7% in August and 26.1% over the period. Orders for total durable goods jumped 1.8% in August, while July's 0.1% dip was revised to a 0.5% gain, pushing orders up 62.8% during the 16 months through August and 14.1% above its pre-pandemic level. Excluding transportation, orders advanced all 16 months since bottoming last April, up 0.2%m/m and 32.5% over the period—18.6% higher than its pre-Covid reading. In August, orders for volatile aircraft (78.0%) led gains, with orders for electrical equipment & appliances (1.3), communications equipment (1.1), and fabricated metals (2.0) also in the black; electrical equipment & appliance orders hit a new record high, and fabricated metals orders rose back to within 0.2% of April's record high. Meanwhile, orders for machinery dipped 1.2%, holding near July's record high, while motor vehicle orders remain depressed due to supply shortages. Looking ahead, flash estimates for September show the IHS Markit M-PMI (to 60.5 from 61.1) eased a bit, but was above 60.0 for the sixth straight month, with the new orders rate of growth holding strong, as client demand remained substantial.

Regional M-PMIs (*link*): Four Fed districts—New York, Philadelphia, Kansas City, and Dallas—now have reported on manufacturing activity for September and show the manufacturing sector expanded at an accelerated pace—as growth in both the New York and Philadelphia regions picked up. The composite index climbed to 22.9 this month, after slowing from 30.6 to 18.9 last month, as the New York (to 34.3 from 18.3) manufacturing sector accelerated back toward July's (43.0) record-breaking pace, while Philadelphia's (30.7 from 19.4) also grew at a faster rate during the month. Meanwhile, manufacturing activity in the Kansas City (to 22.0 from 29.0) and Dallas (4.6 from 9.0) areas slowed, though the former remained at a robust pace while the latter was the weakest since July 2020. The new orders measure showed that growth in billings eased for the second month to 16.5 this month from 21.8 in August and 25.8 in July, even though the New York (to 33.7 from 14.8) region posted its best growth in orders since 2004. Meanwhile, the Philadelphia (15.9 from 22.8) area showed slower, though still solid, growth in billings, while growth in the Kansas City (to 7.0 from 34.0) and Dallas (9.5 from 15.6) regions slowed noticeably this month. Employment (to 23.5 from 23.8) growth continued to hold at a steady pace this month, averaging 23.9 the past four months. Both Dallas (to 26.3 from 21.9) and New York (20.5 from 12.8) factories hired at a faster rate this month, while both Philadelphia (26.3 from 32.6) and Kansas City (21.0 from 28.0) factories hired at a slower pace than August—though at a slightly faster rate than New York's.

Regional Prices Paid & Received Measures (*link*): We now have prices-paid and -received data for September from the Philadelphia, New York, Kansas City, and Dallas regions, and they show that inflationary pressures may have peaked, though the New York and Dallas prices-received measures were outliers. New York's prices-paid measure eased for the fourth month, to 75.7 this month, from May's record high of 83.5, while the prices-received measure (to 47.8 from 46.0) continued to accelerate to yet another record high in the survey's two-decade history. Dallas' (to 44.0 from 38.1) prices-received measure also reached a new record this month, while the prices-paid measure (80.4 from 74.9) accelerated for the second month, back toward its record high of 80.8 in June. Philadelphia's prices-received (52.9 from 53.9) measure held near August's rate—which was the highest since 1974—while the prices-paid measure slipped from 71.2 to 67.3, easing from June's 80.7, the highest since the end of 1979. In the meantime, Kansas City's prices-received (to 40.0 from 61.0) measure slowed measurably from August's record high, while its prices-paid measure was unchanged at 80.0, not far from May's record-high 86.0.

Contact us by *email* or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-228-9102