



MORNING BRIEFING

October 6, 2021

That '70s Show?

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

(1) Panic Attack #70 comes with more baggage than usual. (2) Global energy crisis beats Evergrande for number #1 on worry list. (3) Lots of different reasons for energy troubles in Europe and China. (4) US oil and gas rig count remains low. (5) Weekly US oil output isn't responding to higher oil prices. (6) Parts shortages slamming the brakes on auto sales. (7) More bad news from China: property developers in trouble and more tensions with Taiwan. (8) Tale of two scenarios. (9) Q3 fundamentals likely to be strong, while guidance will be unsettling.

Strategy I: Panic Attack #70. The S&P 500 peaked at a record 4536.95 on September 2 ([Fig. 1](#)). It is down 4.2% through yesterday's close. The Nasdaq is down 6.1% from its record high on September 7 ([Fig. 2](#)). In our opinion, the recent selloff merits inclusion as Panic Attack #70 in our list of panic attacks since 2009. (See our [Table of S&P 500 Panic Attacks Since 2009](#).)

However, Joe and I could identify one main cause for each of the previous 69 panic attacks. This one comes with a long list of worries. In fact, we came up with a list of nine worries in our September 20 [Morning Briefing](#). At the top of the list was Evergrande. We didn't even include a global energy crisis on our worry list; it just came to our attention last week. Now it is at the top of our list:

- (i) Global energy crisis.
- (ii) Evergrande could be China's Lehman or LTCM.
- (iii) Inflation has yet to show signs of peaking.
- (iv) The Fed is expected to start tapering before the end of this year.
- (v) The debt ceiling has to be raised so that the Treasury can pay the bills.
- (vi) Congressional Dems are pushing through huge spending and tax proposals.
- (vii) Parts shortages are forcing companies to scale back their production.
- (viii) Valuation remains elevated.
- (ix) There are plenty of geopolitical risks.
- (x) And oh yeah, the pandemic is still out there.

Last year's pandemic-related lockdowns around the world caused oil, gas, and coal prices

to plunge. Producers of these fossil fuels slashed their capital spending. As economies reopened and governments provided massive fiscal and monetary stimulus, demand for energy soared. So did energy prices because of shortages of fossil fuels, especially coal and gas.

These shortages were exacerbated by government missteps and intrigue. Consider the following:

(1) *Europe*. Russia has been delivering gas to Europe under its contractual obligations. Europe needs more supplies of gas to make up for setbacks in renewable sources of energy, especially electricity generated by wind turbines and hydroelectric power. The Russians refuse to provide more gas through Ukrainian pipelines, which have ample capacity. They obviously are attempting to blackmail their European customers into providing Nord Stream 2 with an operating license as soon as possible. This new pipeline runs on the bed of the Baltic Sea from Russia to Germany and has just started to be tested. The price of natural gas in the US has soared 127% ytd through Monday ([Fig. 3](#)).

(2) *China*. Meanwhile, the Chinese government slashed its purchases of coal from Australia because the government there has been calling for an independent investigation of the origin of Covid-19 in China. As a result, the Chinese government has been forced to order blackouts that are depressing production and exacerbating global supply-chain disruptions. China's PPI for coal was up 57.1% y/y through August ([Fig. 4](#)).

(3) *OPEC+*. On Monday, OPEC+ announced that it would stick to an existing pact for a gradual increase in oil output, sending crude prices to three-year highs and adding to inflationary pressures that consuming nations fear will derail an economic recovery from the pandemic. OPEC+ chose to ignore calls from big consumers, such as the US and India, for extra supplies after oil prices surged more than 50% this year. OPEC+ "reconfirmed the production adjustment plan," the group said in a statement issued after online ministerial talks, referring to a previously agreed deal under which 400,000 barrels per day (bpd) would be added in November. The price of a barrel of Brent crude oil is up from last year's low of \$19.33 on April 21 to over \$80 yesterday ([Fig. 5](#)).

(4) *US*. Notwithstanding soaring oil and gas prices, the numbers of oil and gas rigs remain considerably below their prior peaks ([Fig. 6](#)). US crude oil field production is almost 2.0 million barrels below its record high during 2019 ([Fig. 7](#)). Fossil fuel energy companies slashed their capital spending last year as the prices of oil, gas, and coal dropped. They aren't responding to the rebound in energy prices by expanding their capacity because

climate change activists in both the private and public sectors are forcing them to spend more on developing renewable sources of energy. However, these alternative sources are not as reliable as fossil fuels.

Strategy II: Updating the Worry List. Meanwhile, some of the other worries on our worry list have become more worrisome:

(1) *Supply bottlenecks.* The shortage of chips is significantly depressing auto production and sales. Last week, we reported that Ford was parking thousands of new trucks at the Kentucky Speedway owing to lack of key semiconductor parts. Motor vehicle sales plunged 6.2 million units (saar) from a recent high of 18.5 million units during April to 12.3 million units during September, led by a 4.6 million unit drop in light truck sales over this period ([Fig. 8](#)).

September's PMI survey for manufacturing showed that the new orders index has exceeded the production index for all but two months since June 2020 ([Fig. 9](#)).

The supply-chain disruptions are depressing real GDP. The Atlanta Fed's [GDPNow](#) tracking model showed Q3's real GDP growth at 1.3% as of October 5, down from 2.3% on October 1.

(2) *Inflation and bond yields.* The prices-paid indexes in the M-PMI and NM-PMI remained elevated at 81.2 and 77.5, respectively, during September ([Fig. 10](#)). They were even higher early in the summer. However, both upticked during September and will likely move higher during October reflecting the jump in energy prices.

(3) *China's property bubble.* Evergrande is turning out to be the tip of the iceberg in China's property market. Mid-sized developer Fantasia Holdings missed a bond payment on Monday. Fantasia had issued a statement last month that it had sufficient working capital and no liquidity issues. Kaisa Group, Central China Real Estate, and Greenland became the latest property companies to see their bonds clobbered by uncertainty surrounding debt troubles at China Evergrande. Since China stepped up its scrutiny of developers with its "three red lines" leverage targets in August last year, the taps have dried up for the industry.

(4) *Taiwan.* The BBC [reported](#) that Taiwan has urged Beijing to stop "irresponsible provocative actions" after a record number of Chinese warplanes entered its air defense zone on Monday. The incursion marks the fourth straight day of such flights by Chinese aircraft, with almost 150 aircraft sent into Taiwan's defense zone in total.

The BBC noted: “In an [essay](#) for *Foreign Affairs* magazine on Tuesday, Taiwan’s President Tsai Ing-wen warned there would be ‘catastrophic’ consequences for peace and democracy in Asia if the island were to fall to China. ... Beijing is becoming increasingly concerned that Taiwan’s government is moving the island towards a formal declaration of independence and wanted to warn President Tsai against taking steps in that direction.”

(5) *The pandemic*. And let’s not forget that the pandemic isn’t over. New Zealand is giving up on its “Covid Zero” policy. That’s because notwithstanding closing its borders and enforcing strict lockdowns, the Delta variant continues to spread. Instead of zero tolerance, the government is moving on measures to help it coexist with the virus, as have other Asia-Pacific countries.

Strategy III: Tale of Two Scenarios. “What Are the Odds?” That was the title of our September 27 [Morning Briefing](#). Debbie and I discussed the odds of the current decade playing out like either the Roaring ’20s (TRT-2.0) or the Great Inflation of the ’70s (TGI-2.0). We reiterated our subjective probabilities for the two scenarios and are doing so again now. We assign a 65% subjective probability to TRT-2.0 and 35% to TGI-2.0.

We don’t mean to suggest that this two-scenario paradigm means that only one scenario will get the entire decade right. The outcome may very well be some mix of the two. Or one might prevail through, let’s say, the first half of the decade, while the other does so over the rest of the decade.

For example, the events of last week suggested a replay of the Great Inflation scenario. There were lots of inflationary happenings during the 1970s, but the two major events were the oil crises of 1973 and 1979. The results were long lines to fill cars with gasoline, a wage-price spiral, stagflation, and two recessions. This time, we might be experiencing another energy crisis that has the potential to boost inflation and eventually cause a recession. We will keep you posted on the tale of the two scenarios through the end of the decade.

Strategy IV: Fundamentals Remain Strong. The good news is that the underlying fundamentals for the stock market remain solid. S&P 500 forward revenues rose to yet another record high during the September 23 week ([Fig. 11](#)). Forward earnings also rose to a new record high during the September 30 week.

At the end of September, industry analysts estimated that S&P 500 operating earnings rose

26.9% y/y during Q3 following Q2's 88.6% gain ([Fig. 12](#) and [Fig. 13](#)). Joe and I expect yet another earnings hook during the current earnings season (for Q3) as results once again beat expectations. However, this time we expect to hear lots of unsettling guidance about rising labor costs and widespread labor shortages. We also expect to hear more bad news about supply-chain disruptions.

Joe and I still expect to see 4500-4800 on the S&P 500 by the end of this year. However, October could see more sideways volatility, with the S&P 500 Energy and Financial sectors' stocks outperforming Technology. The result may be a buying opportunity in tech stocks, which could lead a year-end Santa Claus rally.

Calendars

US: Wed: ADP Employment Change 428k, MBA Mortgage Applications, Bostic. **Thurs:** Initial & Continuous Jobless Claims 348k/2.78m, Consumer Credit \$17.5b, Natural Gas Storage, Williams. (Bloomberg estimates)

Global: Wed: Eurozone Retail Sales 0.8%*m/m*/0.4%*y/y*, Germany Factory Orders -2.1%, Spain Industrial Production 3.5% *y/y*, McCaul, Wuermeling, Kuroda. **Thurs:** Germany Industrial Production -0.4%, Japan Household Spending -2.0%*m/m*/-1.5%*y/y*, Japan Leading & Coincident Indicators, China Caixin NM-PMI, ECB Publishes Account of Monetary Policy Meeting, RBA Financial Stability Review, Schnabel, Lane, Elderson, Mauderer, Buch, Macklem. (Bloomberg estimates)

Strategy Indicators

S&P 500 Q3 Earnings Trend vs. Past Quarters ([link](#)): With the September-quarter books closed, the current Q3-2021 earnings forecast of \$49.11 per share has risen 3.3% since the quarter's start. While that's a slowdown from the 7.2% and 5.7% gains over comparable weeks during Q2-2021 and Q1-2021, respectively, the increase indicates there will be another strong earnings surprise hook. The gain in the Q3 forecast marks a record-high fifth straight quarter that consensus forecasts rose throughout the quarter and is well above the average three-month decline of 4.2% for all quarters since Q1-2000. Analysts expect Q3 earnings will rise 26.9% *y/y*, but we think earnings will be about \$53.00 and *y/y* growth will

be 37.0%. That's above the \$52.75 reported for Q2, but the y/y growth rate will slow markedly from 88.5%. Q3-2021 should mark the fifth straight positive surprise for the S&P 500 and its 49th in the past 50 quarters. The Q3 earnings forecast rose during the quarter for eight of the 11 S&P 500 sectors. Here's how they ranked: Energy (24.8%), Materials (10.2), Communication Services (7.8), Information Technology (5.6), S&P 500 (3.3), Health Care (2.9), Financials (2.0), Real Estate (1.6), Industrials (0.8), Consumer Staples (-2.3), Utilities (-5.2), and Consumer Discretionary (-6.8).

US Economic Indicators

Auto Sales ([link](#)): Chip shortages kept motor vehicle sales going in reverse again in September. Total sales sank to a 16-month low of 12.3mu (saar) last month, after accelerating from 16.1mu in February to 18.5mu by April—its best reading since the summer of 2005, when aggressive incentives boosted sales above 20.7mu. Domestic light truck sales slid for the fifth month to 7.2mu (saar) from 11.0mu in April—which was the highest since July 2005; these sales had plunged to 5.3mu last April. Meanwhile, domestic cars sales remained in a rut, falling for the fifth month from 2.8mu in April to 1.6mu (saar) last month. That's above last April's record low of 1.4mu, though less than half the 3.3mu posted at the beginning of 2020. In the meantime, sales of imports also fell for the fifth month to 3.4mu (saar); they had soared from 1.9mu last April to 4.7mu (saar) this April—the best sales pace since the late 1980s—led by a record 3.3mu in light truck sales! Light truck sales were unchanged at 2.4mu (saar) in September.

Merchandise Trade ([link](#)): The real merchandise trade deficit widened to \$101.8 billion in August after narrowing from a near-record \$105.0 billion deficit during June to \$99.8 billion in July. Latest data suggest trade will be a positive to Q3 GDP growth, after subtracting from growth the prior four quarters—as the July/August average deficit of \$100.8 billion is below the Q2 average deficit of \$101.7 billion. Real exports advanced 1.6% during the two months through August after declining 2.7% during the two months through June, while real imports declined 0.4% and rose 1.0% over the comparable periods. Real exports and imports are up 8.0% and 8.9% y/y, slowing from recent peak rates of 34.5% and 26.7%, respectively, during May. Real exports of both consumer goods (nonfood) excluding autos and industrial materials & supplies reached new record highs in August, with the former rebounding 12.3% over the four months through August and the latter jumping 6.3% during August. Meanwhile, real exports of foods, feeds & beverages is in a freefall, plunging 28.4% ytd, while real exports of automotive vehicles & parts are down 16.2% over the comparable

period. Real exports of capital good ex autos remains in a flat trend around recent highs. Looking at imports, real imports of industrial materials & supplies is on a volatile uptrend, climbing 3.9% in August and 15.1% since its recent low last September, while real imports of both capital goods ex autos and foods, feeds & beverages are just below record highs. In the meantime, real imports of automotive vehicles & parts are down 16.7% ytd, while real imports of consumer goods (nonfood) excluding autos are down 5.5% since reaching a record high in March.

Global Economic Indicators

Global Composite PMIs ([link](#)): Global demand in September accelerated for the first time in four months, though at a modest rate. The C-PMI climbed to 53.0 last month after falling from 58.5 in May to a seven-month low of 52.5 in August. The C-PMI for the advanced economies (to 53.8 from 54.1) saw activity slow for the fourth month since peaking at 61.2 in May, while the C-PMI for emerging economies (49.3 from 52.0) contracted for the first time since last June; it peaked at 54.9 in November. The report notes that expansions were recorded in the Eurozone, US, UK, India, Brazil, and Russia, with the Eurozone having the top-four ranked countries. Of the 11 nations that experienced growth, seven (including the US, Germany, and India) saw slower rates of growth, while growth in Japan and Australia contracted last month. During September, the Global NM-PMI (to 53.4 from 52.8) accelerated a bit in September, while the Global M-PMI was unchanged at 54.1; both were weaker than rates earlier this year. Inflationary pressures remained high, with input costs accelerating at the sharpest pace in four months, resulting in an elevated rate of output inflation.

US Non-Manufacturing PMIs ([link](#)): The US service sector continued to expand at a robust pace in September, according to ISM, with its measure holding near July's record pace. The IHS Markit measure, on the other hand, posted its slowest pace in nine months, seeing the slowest rise in new business in 13 months. ISM's NM-PMI ticked up to 61.9 in September after slipping from a record-high 64.1 in July to 61.7 in August. Both the new orders (to 63.5 from 63.2) and production (62.3 from 60.1) measures remained above 60.0, while employment (53.0 from 53.7) continued to expand at a steady pace after contracting in June. The supplier deliveries (to 68.8 from 69.6) measure remained around recent highs, reflecting the difficulties suppliers continue to experience due to the Covid-19 impact. In the meantime, price pressures remained intense, climbing from 75.4 to 77.5 last month, not far from July's 82.3—which wasn't far from its all-time high of 83.5 during September 2005.

Switching to the IHS Markit NM-PMI measure, it fell for the fourth month, from 70.4 in May to a nine-month low of 54.9 in September—though the latest reading was little changed from August’s 55.1. Business activity is growing at a rate in line with the long-run average seen prior to the pandemic, though “represents a marked downshifting from the spring and summer months.” The report notes that high virus case numbers not only have subdued demand for many services, primarily in the hospitality sector, but also have continued to hit the labor market, both in terms of staff absences and low labor market participation rates, as manufacturers struggle to fill vacancies. As for price pressures, input prices continued to rise at a steep rate, though firms are passing on these higher costs to clients at the slowest pace in five months.

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

Copyright (c) Yardeni Research, Inc. Please read complete [copyright and hedge clause](#).

