MORNING BRIEFING
November 30, 2021

Is America Shovel Ready?

Check out the accompanying chart collection.

(1) Obama's insight: Shovel-ready projects don't exist. (2) Biden needs construction workers for his BBB infrastructure projects. (3) The difference between "shovel ready" and "shovel worthy." (4) Meet Mitch Landrieu, the new infrastructure czar. Wish him luck. (5) A dismal history of big infrastructure spending. (6) Construction costs are high. (7) Construction workers have plenty of work now. (8) Durable goods orders are booming, and shipments aren't lagging far behind notwithstanding supply-chain issues. (9) Forward earnings of S&P 500 Industrials soaring along with orders. (10) IT equipment output is also booming.

Infrastructure I: The Hope. In an hour-long *interview* with *The New York Times* on October 12, 2010, President Barack Obama explained why the unemployment rate was still hovering around 10% nearly two years after he signed his economic stimulus package. The President acknowledged that, despite his campaign promises, "there's no such thing as shovel-ready projects." Local governments were still facing delays spending the money they were allocated from the stimulus program.

Now President Joe Biden has signed an infrastructure bill for a country that's even less shovel ready than it was back when he was Obama's vice president because of today's severe shortage of construction workers. Let's have a look at the facts and figures on the ground today:

(1) President Biden signed the $1 trillion Build Back Better infrastructure bill into law on Monday afternoon, November 15. It was a bipartisan victory for the Biden administration. Biden grandly declared: "I truly believe that 50 years from now, historians are going to look back at this moment and say, that's the moment America began to win the competition of the 21st century."

The act pours billions into the nation's roads, ports, and power lines. It budgets $500 billion to highways, $39 billion to urban transit, $65 billion to broadband projects, and $73 billion to electrical grids, among other items. The nation's busiest passenger rail line, Amtrak's Boston-to-Washington corridor, gets the biggest slice of a $66 billion rail package.

(2) The November 15 *NYT* *reported*: "The infrastructure spending will not jolt the American economy like a traditional economic stimulus plan, nor is it meant to. Officials say the administration will focus as much on 'shovel-worthy' projects—meaning those that make the most of federal dollars—as they will on 'shovel-ready' ones that would dump money into the economy more quickly." The administration claims that the package was designed to deliver money over several years, partly to avoid adding to mounting inflationary pressures.

(3) Indeed, the President has claimed that the legislation's infrastructure spending should help to reduce inflation by boosting productivity as roads and bridges are rebuilt, freight and passenger rail systems upgraded, and environmental pollution cleaned up.

"This is not designed to be stimulus," said Cecilia Rouse, chair of the White House Council of Economic Advisers. "It's designed to be the most strategic, effective investments so that we can continue to compete against China and other countries that are making bigger investments in their infrastructure." She added, "We will see investments starting next year … beginning with our ports, and beginning with other areas where we know we are far behind."

(4) To be clear, while the infrastructure spending act is billed as a $1 trillion initiative, only about $550 billion of that represents an increase over current spending levels.

(5) On November 14, Biden named Mitch Landrieu, a former mayor of New Orleans and a former lieutenant governor of Louisiana, to oversee the $1 trillion in infrastructure spending. The White House *announcement* observed: "As Mayor of New Orleans, Landrieu took office at a time when the city's recovery from the devastation of Hurricane Katrina had stalled. He hit the ground running, fast-tracking over 100 projects and securing billions in federal funding for roads, schools, hospitals, parks and critical infrastructure, turning New Orleans into one of America's great comeback stories."

Landrieu was also chair of the US Conference of Mayors, so he knows lots of the local officials around the country who will have to work with him to get his job done.

Infrastructure II: The Challenge. The November 28 *NYT* featured an *article* titled "Years of Delays, Billions in Overruns: The Dismal History of Big Infrastructure." It lays out the challenges, hurdles, and obstacles that Landrieu will have to overcome. The article warns: "As the nation sets out on a national spending spree fueled by the $1.2 trillion infrastructure bill signed by President Biden this month, the job ahead carries enormous risks that the projects will face the same kind of cost, schedule and technical problems that have hobbled ambitious efforts from New York to Seattle, delaying benefits to the public and driving up the price tag that taxpayers ultimately will bear."

The article points out that the challenges to restoring America's infrastructure "have grown more potent" in recent years. Among the litany of potential potholes cited: "Agencies have less internal technical talent. Legal challenges have grown stronger under state and federal environmental laws. And spending on infrastructure as a fraction of the economy has shrunk, giving local agencies less experience in modern practices."

Infrastructure III: The Numbers. There is certainly a pressing need to upgrade the country's infrastructure. The *World Economic Forum* ranks the US 13th in terms of overall quality of infrastructure. More than 45,000 US bridges and one in five miles of roads are in poor condition, per the *American Society of Civil Engineers*.

Here are some of the challenges ahead:

(1) The construction industry is facing sharply growing costs for steel products, up by 101% over the last 12 months, and other key materials (*Fig. 1* and *Fig. 2*).

(2) Shortages of skilled labor are worsening, exacerbated by Covid-induced retirements. Payroll employment in the construction industry recovered to 7.5 million during October, only 150,000 below its pre-pandemic peak of 7.6 million during February 2020 (*Fig. 3*). The 3.1 million workers in the residential construction sector during October surpassed its pre-pandemic level, while the 3.4 million workers in the nonresidential sector during the month was 182,000 below its pre-pandemic high.

(3) Finding more construction workers to meet the needs of the administration's infrastructure program will be tough and will drive up labor costs in the construction industry, in which the number of quits has been increasing in recent months (*Fig. 4*). And construction hires are down in recent months, undoubtedly reflecting a shortage of workers rather than weakening demand for them.

(4) October saw the average hourly earnings of all construction workers rise 4.7% y/y and that of the industry's production and nonsupervisory workers rise 5.2% (*Fig. 5*).

(5) During periods of economic expansion, residential and nonresidential construction spending tend to well exceed public construction (*Fig. 6* and *Fig. 7*). During September, spending on residential, nonresidential, and public construction totaled $774 billion, $456

billion, and $344 billion at seasonally adjusted annual rates. It is likely to be tough for contractors chosen to Build Back Better to do so if they can't attract workers with the necessary skills.

Capital Spending: The Big Boom! Capital spending is shovel ready! Actually, it has been booming in recent months. Debbie and I believe that employers are quickly realizing that labor shortages are here to stay. These shortages are structural; they are chronic. So company managements are scrambling to spend on productivity-enhancing capital equipment, especially those that use state-of-the-art technologies to boost both the manual and mental productivity of workers. Consider the following:

(1) Durable goods orders excluding transportation has soared 34.1% since bottoming last year during April through October of this year (*Fig. 8*). It has been in record-high territory since December. Nondefense capital goods orders excluding aircraft is up 31.3% over the same period and has been rising in record territory since last November. Shipments data have been closely tracking the orders data, which is impressive given all the angst about supply-chain disruptions.

(2) The following categories of new orders have been leading the charge higher and were at record highs during October: fabricated metals products; machinery; electrical equipment, appliances & components; and all other durable goods (*Fig. 9*).

In the machinery category, September data showed record orders for industrial, metalworking, and material handling machinery (*Fig. 10*). Orders for construction, farm, and mining machinery were also strong.

(3) It's no wonder that the forward earnings of the S&P 500 Industrials sector recently rose to a record high, slightly exceeding its pre-pandemic record high (*Fig. 11*). The forward earnings of the sector's Construction Machinery & Heavy Trucks industry has almost fully recovered as well (*Fig. 12*). At record highs are the forward earnings of the Industrial Machinery, Electrical Components & Equipment, Air Freight & Logistics, and Railroads industries. Lagging behind are Aerospace & Defense and Industrial Conglomerates.

(4) Previously, we observed that high-tech capital spending now accounts for just over 50% of total current-dollar capital spending (*Fig. 13*). Its share is at a record high. That is probably an underestimate because it includes only spending on IT equipment, software, and R&D. Not included are all the technologies embedded in most machinery.

Also at or near record highs are the industrial production indexes for communications equipment, computer & peripheral equipment, and semiconductors (*Fig. 14*).

Calendars

US: Tues: Consumer Confidence 110.9; S&P/CS HPI 20-City Composite 1.1%m/m/19.3%y/y; Chicago PMI 68.2; API Weekly Crude Oil Inventories; Powell. **Wed:** ADP Employment 520k; ISM M-PMI & Price Index 61.0/85.5; Motor Vehicle Sales; Construction Spending 0.4%; MBA Mortgage Applications; Crude Oil Inventories; Beige Book; Powell. (Bloomberg estimates)

Global: Tues: Eurozone CPI 4.4%y/y; Germany Unemployment Change & Unemployment Rate -25k/5.3%; France GDP 3.0%; France Consumer Spending 0.3%; Italy GDP 2.6%; Italy CPI 0.4%m/m/3.2%y/y; Canada GDP 0.1%m/m/3.0%q/q; China Caixin M-PMI 50.5; Japan Housing Starts 5.2%; Australia GDP -2.7%q/q/3.0%y/y. **Wed:** Eurozone, Germany, France, Italy, and Spain M-PMIs 58.6/57.6/54.6/61.1/57.9; Germany Retail Sales 1.0%m/m/-2.0%y/y; UK M-PMI 58.2; UK Nationwide HPI 0.5%m/m/9.3%y/y; Australia Retail Sales 4.9%; Beermann, Suzuki. (Bloomberg estimates)

Strategy Indicators

S&P 500 Sectors Net Earnings Revisions (*link*): The S&P 500's NERI weakened in November for a fourth straight month, and posted its biggest m/m decline in 18 months as the index and many of its sectors fell to their lowest readings in more than a year. NERI tumbled to 7.2% in November from 16.1% in October and is down from a record-high 23.1% in July, but was positive for a 16th month following 13 straight negative readings. October's monthly reading had been its ninth highest dating back to the start of the data series in March 1995, with six of those highs occurring from May to October. November's reading compares to an 11-year low of -37.4% in May 2020 and its prior tax-cut-induced record high of 22.1% in March 2018, when it was positive for 18 straight months through October 2018. Eight of the 11 S&P 500 sectors had positive NERI in November, down from all 11 sectors with a positive reading in September and October. Energy was the only sector to have NERI improve m/m in November, down from two sectors rising m/m in October. Just four sectors had NERIs in the double digits during the month, down from nine sectors meeting that criteria in October. Here are the November NERIs for the S&P 500 and its sectors compared with their October readings: Energy (35.1% [16-year high] in November, up from 32.8% in October), Information Technology (12.7 [11-month low], 23.9), Financials (10.8 [14-month low], 15.2), Real Estate (10.1, 19.6), Consumer Discretionary (7.8 [15-month low], 17.1), S&P 500 (7.2 [16-month low], 16.1), Health Care (3.3 [16-month low], 13.7), Materials (3.2 [16-month low], 10.1), Utilities (2.1, 3.7), Consumer Staples (-0.2 [16-month low], 4.7), Communication Services (-0.9 [16-month low], 17.1), and Industrials (-0.9 [16-month low], 12.5).

S&P 500/400/600 Forward Earnings (*link*): Among these three indexes, all but MidCap had forward earnings at a record high last week. LargeCap's was at a record high for a ninth straight week after dropping a hair below in late September due to Match's addition to the index. MidCap's dropped 0.1% below its record high a week earlier and was down for just the second time in six weeks. SmallCap's was at a record for a 12th week after dropping in early September for the first time in six months. In what has shaped up to be an extraordinary V-shaped recovery, LargeCap's forward earnings has risen during 77 of the past 80 weeks, with the down weeks due to Tesla's addition to the index last December, Amazon's earnings shortfall in August, and Match's addition to the index in late September. MidCap's forward earnings is up in 74 of the past 78 weeks, and SmallCap's posted 75 gains in the past 79 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 56.6% from its lowest level since August 2017; MidCap's is now up 107.7% from its lowest level since May 2015; and SmallCap's has soared 176.1% 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 ticked down to 32.8% y/y in the latest week; and is 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 51.3% y/y from 53.1%; that's down from a record high of 78.8% at the end of May and compares to a record low of -32.7% in May 2020. SmallCap's rate dropped to 69.8% y/y from 71.4%; 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 (47.6%, 7.9%), MidCap (78.3, 8.0), and SmallCap (123.8, 13.5).

S&P 500/400/600 Valuation (*link*): Valuations dropped across the board for these three indexes last week. LargeCap's forward P/E dropped 0.6pt w/w to 20.8. That's down from a six-month high of 21.5 in early November, and compares to an 11-month low of 20.3 in early October. LargeCap's forward P/E also 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 0.5pt to a 19-month low of 16.2 and is down from a 13-week high of 17.1 four weeks ago. That compares to a seven-month high of 20.5 in early March and is 6.7pts below its record high of 22.9 in June 2020. SmallCap's dropped 0.6pt to a 20-month low of 14.8 and is down from a 13-week high of 16.1 four weeks earlier. It's now still down 11.9pts from its record high of 26.7 in early June 2020, when forward earnings was depressed. 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; MidCap's current 22% discount to LargeCap is its biggest since January 2001. SmallCap's P/E was below LargeCap's for a 67th week. That's the longest stretch at a discount since 1999-2002; SmallCap's current 29% reading is its biggest since April 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 24th straight week; SmallCap's current 8% discount to MidCap's is its biggest since July 2001.

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 endured even through the Q3 earnings warnings season, when forecasts typically decline. With the Q3 earnings reports over 97% complete, the S&P 500's Q3-2021 blended earnings-per-share estimate/actual rose 7 cents w/w to $53.82. That represents a gain of 39.1% y/y on a frozen actual basis and a 42.3% y/y gain on a pro forma basis. Q3 marks the third straight quarter of double-digit percentage earnings growth, but is down from their respective growth rates of 88.5% and 96.3% in Q1- and Q2-2021. All 11 sectors again posted positive y/y earnings growth during Q3-2021. Here are the S&P 500 sectors' latest earnings growth rates for Q4-2021 versus their blended Q3-2021 growth rates: Energy (over 10,000% in Q4-2021 versus 1,793.1% in Q3-2021), Materials (63.0, 89.2), Industrials (51.4, 86.9), S&P 500 (21.7, 42.3), Health Care (19.3, 28.9), Real Estate (13.3, 34.5), Information Technology (15.0, 37.4), Communication Services (9.3, 35.5), Consumer Discretionary (6.4, 18.9), Financials (2.9, 36.0), Consumer Staples (1.7, 6.9), and Utilities (0.6, 10.3).

US Economic Indicators

Regional M-PMIs (*link*): Four Fed districts (New York, Philadelphia, Kansas City, and Dallas) now have reported on manufacturing activity for November and show the manufacturing sector expanded at a near-record pace. The composite index rebounded to 26.4 this month after falling to 18.9 in August, closing in on April's record high of 36.2. Both the Philadelphia (to 39.0 from 23.8) and New York (30.9 from 19.8) regions showed a sharp acceleration in growth, while the Kansas City (24.0 from 31.0) region showed slower, though still robust, growth. The Dallas (to 11.8 from 14.6) region held at a steady pace this month. New orders (to 23.0 from 24.3) continued to grow at a healthy pace as billings in the Philadelphia (to 47.4 from 30.8) region expanded at the fastest pace since the early 1970s—and not too far from its record-high 56.2—while New York (28.8 from 24.3) and Dallas (19.6 from 14.9) billings continued to grow at a strong rate. Orders growth in the Kansas City (to -4.0 from 27.0) region, however, moved from expansion to contraction. Job gains remained strong, with the employment (to 27.2 from 27.5) measure holding just below October's record pace. Employment was strong in all four regions, with New York's (to 26.0 from 17.1) accelerating and Dallas' (28.5 from 28.3) holding steady, while Philadelphia (27.2 from 30.7) and Kansas City (27.0 from 34.0) measures slowed a bit—though were still slightly above New York's pace.

Regional Prices Paid & Received Measures (*link*): Inflationary pressures remain elevated in November, with New York's prices-received (to 50.8 from 43.5) measure accelerating to a new record high this month and its prices-paid measure (83.0 from 78.7) moving back toward May's record-high 83.5. Dallas' prices-paid measure (to 82.1 from 76.3) jumped to a new record high, while its prices-received (42.2 from 49.8) gauge eased from October's record high. Philadelphia's prices-received (to 62.9 from 51.1) measure climbed to within striking distance of February 1974's record high of 63.8, while its prices-paid (80.0 from 70.3) gauge is just shy of June's 80.7—which was the highest since mid-1979. Meanwhile, Kansas City's measures have eased. Its prices-received (to 50.0 from 47.0) measure accelerated a bit this month, though was below its record high of 61.0 recorded this August, while its prices-paid (77.0 from 87.0) measure slowed from October's record high.

Pending Home Sales (*link*): "Motivated by fast-rising rents and the anticipated increase in mortgage rates, consumers that are on strong financial footing are signing contracts to purchase a home sooner rather than later," said Lawrence Yun, NAR's chief economist. "This solid buying is a testament to demand still being relatively high, as it is occurring during a time when inventory is still markedly low." The Pending Home Sales Index (which tracks sales when a contract is signed, but the transaction has not yet closed) rebounded 7.5% in October, reversing September's decline, though is still 1.4% below last October. Regionally, sales increased in all regions in October, however, were split versus a year ago—with two regions above and two below. Here's a regional look at pending home sales in October: Midwest (+11.8% m/m & +5.1% y/y), South (+8.0 & +0.6), Northeast (+6.9 & -10.0), and West (+2.1 & -6.2). Yun notes that October's significant increase assures that total existing home sales this year will exceed 6.0 million units—which will be the best performance in 15 years.

Global Economic Indicators

Eurozone Economic Sentiment Indicators (*link*): The Economic Sentiment Index (ESI) for both the EU (-1.1 points to 116.5) and Eurozone (-1.1 points to 117.5) moved lower in November, with both down 1.5 points from their July record highs of 118.0 and 119.0, respectively. Among the largest EU countries, November's performance was a mixed bag, with ESIs in France (+3.0 points to 116.1), Italy (+0.9 to 119.5), and Poland (+0.5 to 107.1) moving up and with France and Italy ESIs within a fraction of their July cyclical highs of 116.4 and 119.6, respectively. Meanwhile, ESIs in Spain (-2.6 to 109.3), the Netherlands (-2.1 to 110.3), and Germany (-1.7 to 115.8) all moved lower. For the overall Eurozone at the sector level, retail trade confidence improved for the second month, to 3.7, back near its recent peak of 4.7 in June, while construction confidence advanced for the fourth month, by 5.0 points to 9.0. Service (18.4) confidence held around recent highs—moving 7.0 points above its pre-pandemic level—while industrial confidence (14.1) was unchanged at its second-highest reading on record. Meanwhile, consumer confidence dropped for the second month to -6.8 after reaching a recent high of -3.3 in June; it was at -17.6 a year ago.

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