MORNING BRIEFING
January 25, 2022

MAMU, R.I.P.

Check out the accompanying chart collection.

(1) With benefit of hindsight, MAMU is dead. (2) Retreating speculative excesses is a good thing as long as nothing breaks. (3) Taking some air out of MegaCaps is also good for the long-term health of the market. (4) Lots of bearish sentiment in options market and in Bull/Bear Ratio. (5) Can the Treasury market absorb an extra $175 billion per month? (6) A short history of Quantitative Tightening. (7) Xi wants Powell to cease and desist. (8) Record-low births of Chinese babies in 2021. (9) World's largest nursing home.

Strategy: Meltups and Meltdowns. With the benefit of hindsight, the "Mother of All Meltups" ("MAMU") best describes events in the stock market during 2020 through early 2021. Some of the resulting bubbles started losing air last year. Consider the following:

(1) As Joe and I observed yesterday, the ARK Innovation ETF rose 158% from March 23, 2020 to its peak on February 12, 2021. It is down 53.0% since then through yesterday's close. The air has also been coming out of the "meme" stocks owned by the Robinhood crowd and the stocks of SPACs (special purpose acquisition companies, a.k.a. "blank-check" companies) as well as the cryptocurrency bubble. Bitcoin peaked at a record $67,633.65 on November 8 and fell 48.3% to $34,971.90 through Sunday's close (*Fig. 1*). The valuations of the S&P SMidCaps (i.e., the S&P 600 SmallCap and the S&P 400 MidCap indexes) dropped sharply last year as their stock price indexes moved sideways while their earnings soared.

In each of these cases, the downdrafts occurred without any dire consequences for the broader measures of the stock market or for the economy.

(2) But since late last year, the broader stock market indexes have begun to lose ground after their 2020 and 2021 meltups. The Nasdaq soared 133.7% from 6,869.52 on March 18, 2020 to a record high of 16,057.44 on November 11, 2021 (*Fig. 2*). It was down 13.7% as of yesterday's close.

The S&P 500 bottomed at 2237.40 on March 23, 2020 and rose 114.4% to peak at a record high of 4796.56 on January 3, the first trading day of 2022. It was down 8.1% through

yesterday's close, following an amazing turnaround Monday.

(3) The S&P 500's MegaCap-8 stocks (i.e., the eight highest-capitalization stocks in the index) collectively peaked at a record high on December 27 and fell 14.0% through Friday's close (*Fig. 3*). The MegaCap-8s account for about 50% of the market cap of the S&P 500 Growth stock price index, which peaked on December 27 and is down 13.0% since then through Friday's close (*Fig. 4*).

(4) The stock market's recent taper tantrum is unlikely to change the hawkish course of monetary policy. The Fed is still likely to stop purchasing bonds in March, and then start raising the federal funds rate and start running off maturing securities from its balance sheet. The FOMC might signal a bit of concern about the recent stock market selloff by signaling that the first of the coming rate hikes might be 25bps rather than 50bps.

(5) The good news is that bearish sentiment has risen sharply recently, which is a bullish development from a contrarian perspective. The CBOE equity put/call ratio rose to 0.82 on January 21, which is the highest reading since the 2020 pandemic lockdown selloff (*Fig. 5* and *Fig 6*).

The weekly Bull/Bear Ratio (BBR) compiled by Investors Intelligence was down to 1.59 during the January 18 week from 4.00 at last year's peak during the July 13 week. The way the market traded this past week, the BBR likely fell closer to 1.00, which in the past has been a remarkably good buying indicator. I bet we'll learn that it fell to that level when we get the January 25 reading on January 26 (*Fig. 7* and *Fig. 8*).

Monetary Policy: The Fed's Runoff, Now & Then. What impacts might the Fed's runoff have on the money supply and the financial markets? Yesterday, Melissa and I observed that within the next 12 months, $1.14 trillion of the Fed's Treasuries will mature (*Fig. 9*). That averages around $95 billion per month. The Fed is changing course from buying $80 billion of Treasuries per month last year to letting its securities mature without replacing them. So in effect, the Treasury market will have to absorb $175 billion per month in securities on average over the next 12 months once the runoff starts, probably this spring.

The previous episode of the Fed's "Quantitative Tightening (QT)"—i.e., tapering its balance sheet—ran from October 1, 2017 to July 31, 2019 (*Fig. 10*). Over this period, the Fed's holdings of securities declined by $675 billion. The Fed terminated this program earlier than expected because economic growth slowed (*Fig. 11*).

Let’s look at the impacts that the Fed’s past tapering episode had on various economic variables for some guidance on what might be in store for us once the Fed starts tapering again:

(1) *Monetary aggregates.* During the Fed’s previous QT, M2 continued to expand at about the same pace as in the years prior to the program (*Fig. 12*). On the other hand, demand deposits were noticeably flat compared to the years prior to the program (*Fig. 13*).

(2) *Bond yield.* The 10-year US Treasury bond yield rose from 2.33% at the start of the QT period to peak at 3.24% on November 8, 2018. It then fell sharply to end the period at 2.02% (*Fig. 14*).

(3) *Stock market.* The S&P 500 was quite volatile during the previous QT period, which included a taper tantrum during the last three months of 2018 (*Fig. 15*). But it managed to rise 18.3% nonetheless over the QT period.

China: World’s Largest Nursing Home. China is in trouble. That might explain why on Monday, January 17, at a virtual Davos event, Chinese President Xi Jinping warned Fed Chair Jerome Powell against hiking interest rates. He said: “If major economies slam on the brakes or take a U-turn in their monetary policies, there would be serious negative spillovers. They would present challenges to global economic and financial stability, and developing countries would bear the brunt of it.”

China really isn’t a developing country anymore. It is highly developed. Actually, it has a grossly overdeveloped real estate market that might be experiencing the biggest real estate bubble of all times, bigger even than Japan’s during the late 1980s. And the Chinese bubble started to burst late last year.

China also is about to displace Japan as the world’s largest nursing home. The country’s huge population is aging as people live longer and young adults refrain from having many children. Ironically, also on Monday, January 17, data released by the government showed that China’s birth rate dropped to a record low in 2021, extending a downward trend that led Beijing last year to begin allowing couples to have up to three children.

China’s increasingly geriatric demographic profile certainly can explain the calamitous plunge in inflation-adjusted retail sales growth from the high teens only a few years ago to ZERO now (*Fig. 16*).

So Xi doesn't want the Fed to step on the brakes because he needs the US consumer. Last year through November, China was the number-one source of imported goods in the US, at $463 billion, topping Mexico at $350 billion and Canada at $324 billion. Also on Monday, January 17, the People's Bank of China cut two policy rates by 10 basis points.

Powell to Xi: "How do you say 'fuhgeddaboudit' in Chinese?"

Calendars

US: Tues: Consumer Confidence 111.8; Richmond Fed Manufacturing Index 14; S&P Case-Shiller HP Composite 1.0%m/m/18.0%y/y; API Weekly Crude Oil Inventories. **Wed:** New Home Sales 760k; Goods Trade Balance Advance Estimate -$96.1b; Wholesale Inventories 1.3%; MBA Mortgage Applications; Crude Oil Inventories & Imports; FOMC Interest Rate Decision 0.25%. (Bloomberg estimates)

Global: Tues: Germany Ifo Business Climate Index, Present Situation, and Expectations 94.7/96.1/93.0; UK CBI Industrial Trend Orders 22; Japan Core CPI 0.7% y/y; BOJ Summary of Opinions. **Wed:** France Consumer Confidence 98; BOC Interest Rate Decision 0.25%. (Bloomberg estimates)

Strategy Indicators

S&P 500/400/600 Forward Earnings (*link*): All three of these indexes had forward earnings at a record high last week. LargeCap's was at a record high for a fourth week after dropping a week earlier due to index changes. MidCap's was at a record high for a seventh straight week after dropping 0.1% below at the end of November. SmallCap's returned to record-high territory for the first time in five weeks after falling below due to index changes. In what has shaped up to be an extraordinary V-shaped recovery, LargeCap's forward earnings has risen during 83 of the past 87 weeks, with the down weeks due to Tesla's addition to the index in December 2020, Amazon's earnings shortfall in August, and index changes in late December and September. MidCap's forward earnings is up in 81 of the past 85 weeks, and SmallCap's posted 81 gains in the past 86 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 59.5% from its lowest level since August 2017; MidCap's is now up 116.8% from its lowest level since May 2015; and SmallCap's has soared 178.4% 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 dropped to 31.3% y/y from 32.4%; that's 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 was steady w/w at 48.5% y/y; 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 58.4% y/y from 59.1%; 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 (47.9%, 8.3%), MidCap (83.2, 8.4), and SmallCap (121.2, 13.7).

S&P 500/400/600 Valuation (*link*): Valuations fell sharply for all three of these indexes last week. LargeCap's forward P/E dropped 1.2pts w/w to a 21-month low of 19.6. That's down from a six-month high of 21.5 in early November, and compares to its prior 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 1.1pt to a 22-month low of 14.5 and is down from a 13-week high of 17.1 in early November. That compares to a seven-month high of 20.5 in March 2021 and is 8.4pts below its record high of 22.9 in June 2020. SmallCap's shedded 1.2pts to a 22-month low of 13.7. That compares to mid-December's 20-month low of 14.4 and is down from a 13-week high of 16.1 in early November. It's now down 13.0pts 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 26% discount to LargeCap is its biggest since September 2000. SmallCap's P/E was below LargeCap's for a 74th week. That's the longest stretch at a discount since 1999-2002; SmallCap's current 30% reading is near 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 31st straight

week; SmallCap's current 5% discount to MidCap's is near 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 through the latest Q4 earnings warnings season, when forecasts typically decline. The S&P 500's Q4-2021 earnings-per-share estimate rose 37 cents w/w to $51.66, and is up from $51.08 at the beginning of the quarter. That $51.66 estimate represents a gain of 21.3% y/y on a frozen actual basis and a 23.7% y/y gain on a pro forma basis. Q4 is on pace to mark the fourth straight quarter of double-digit percentage earnings growth, but growth is slowing for a second straight quarter. All 11 sectors are expected to post positive y/y earnings growth for a third straight quarter during Q4-2021, but double-digit growth is expected for only seven sectors; that's down from 10 sectors doing so during Q3. Here are the S&P 500 sectors' latest earnings growth rates for Q4-2021 versus their blended Q3-2021 growth rates: Energy (10,787.8% in Q4-2021 versus 1,798.0% in Q3-2021), Materials (63.8, 89.1), Industrials (53.9, 88.4), S&P 500 (23.7, 42.6), Health Care (20.4, 29.0), Information Technology (15.8, 38.2), Real Estate (14.2, 34.4), Communication Services (10.1, 35.6), Consumer Discretionary (9.2, 19.4), Financials (5.9, 35.9), Consumer Staples (3.6, 7.4), and Utilities (0.9, 10.3).

Global Economic Indicators

US PMI Flash Estimates (*link*): US PMI Flash Estimates (link): "US output growth slows to 18-month low as Omicron wave exacerbates supply delays and labor shortages" was the headline of January's flash report. Meanwhile, input price inflation eased again in January—posting its slowest pace since last March. The C-PMI slowed for the third month in January, from 57.6 in October to 50.8 this month—with 6.2 of the 6.8-point drop happening this month. It was at a record-high 68.7 last May. The NM-PMI plunged to 50.9 this month, after averaging 58.1 during Q4; it was at a record-high 70.4 last May. The M-PMI fell for the sixth successive month from 63.4 in July to 55.0 this month—the lowest since October 2020. The report notes that output has been affected by Omicron much more than demand, "hinting that growth will pick up again once restrictions are relaxed." The report also highlighted that the overall rate of supply-chain deterioration has eased compared H2-2021 levels.

Eurozone PMI Flash Estimates (*link*): Growth in the Eurozone slowed to an 11-month low this month, according to flash estimates, as renewed Covid-19 restrictions led to a

noticeable slowing in service-sector growth. Meanwhile, an easing of supply-chain delays provided a boost to manufacturing output. The Eurozone's C-PMI slowed for the fifth time in six months to 52.4 this month from 60.2 in July. Over the period, the NM-PMI sank from 59.8 to a nine-month low of 51.2, while the M-PMI climbed to a five-month high of 59.0 this month, with easing supply-chain delays driving future output expectations to the highest since last June—most notably in Germany. Germany's C-PMI (to 54.3 from 49.9) climbed to a four-month high this month, with the M-PMI (60.5 from 57.4) and NM-PMI (52.2 from 48.7) at their highest levels in five months and two months, respectively. Meanwhile, France's C-PMI (52.7 from 55.8) shows growth was the weakest it's been since last April, as the M-PMI (55.5 from 55.6) stalled and the NM-PMI (53.1 from 57.0) revealed a sharply weaker service sector. The report notes, "growth ground almost to a half across the rest of the region as a whole amid a renewed contraction of service activity." As for inflationary pressures, average prices charged for goods and services rose at a series high, though an easing of producer input cost inflation hinted at a cooling of upward raw material price pressures.

Japan PMI Flash Estimates (*link*): Activity in Japan's private sector contracted in January for the first time in four months, according to the flash estimate, led by the biggest decline in service-sector activity since August. January's C-PMI sank to 48.8 from 52.5 and 53.3 the prior two months, and the NM-PMI dropped from 53.0 to 46.6 over the two-month period, as a surge in cases of the Omicron variant impacted customer-facing industries. This month's decline in the services sector was the sharpest since the Delta-induced contraction in August (42.9). Meanwhile, Japan's M-PMI accelerated to 54.6 this month—the best pace since January 2018. Both output and new order growth accelerated, with the latter rising at a nine-month high. In the meantime, inflationary pressures may have peaked at the end of 2021, as input price inflation this month eased for the first time in five months. Firms remained strongly optimistic about the 12-month outlook—though positive sentiment dipped to a five-month low.

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.