MORNING BRIEFING
February 24, 2022

Sentiment, Industrials, and Crispr

Check out the accompanying chart collection.

Executive Summary: Stock market bearishness is increasing, which is bullish from a contrarian perspective. The Bull/Bear Ratio has dropped close to levels that have heralded great buying opportunities in the past. That doesn't preclude further stock market declines, but it does suggest that bargain buying for the long term makes sense. … A confluence of trends points to boom times for manufacturing industries and the businesses that support them. Some of these trends are industry specific, some apply to manufacturing broadly. … Also: a look at exciting new medical applications for disruptive technology Crispr.

Strategy: Sour Sentiment. The stock market is basically in the hands of Russian President Vladimir Putin and Federal Reserve Chair Jerome Powell. Both have been depressing investors since the start of this year.

The good news right now seems to be that bearishness is increasing, which is bullish from a contrarian perspective. The Investors Intelligence Bull/Bear Ratio dropped to 1.04 this week (*Fig. 1*). Readings of 1.0 or less have provided great buying opportunities in the past (*Fig. 2*). However, those readings don't rule out further near-term declines in the S&P 500. They do suggest that buying bargains now makes sense for long-term investors.

A word of warning, though: Several of the stock market bottoms in the past were made when the Fed reversed course and started to ease monetary policy. This time, the Fed is on course to start tightening monetary policy in March. However, the unfolding Ukraine crisis might cause the Fed to adopt a more gradual monetary tightening path. Much depends on what Putin and Powell do next.

Industrials: The Manufacturing Renaissance. A number of trends in the industrial world are converging to boost all things manufacturing related. Collectively, these trends suggest boom times over the next few years for businesses that support manufacturing in any respect, from building plants to filling them with high-tech equipment and software. Of course, this assumes that World War III isn't about to break out, but let's be optimistic.

Some of the trends are industry specific. For example, the advent of electric vehicles (EVs) and the need for more semiconductor supply are driving automakers' and semiconductor manufacturers' plans to build new plants around the world. Likewise, the surge in e-commerce has sent retail companies scrambling to build fulfillment and shipping centers.

Some trends cut across many industries: All manufacturers need to offset wage increases and labor shortages by increasing the automation in factories. And some manufacturers have started to build new manufacturing capacity in the US given the political uncertainties in China and the rising costs and delays involved with shipping.

I asked Jackie to examine some of the data related to this Manufacturing Renaissance, both the economic data supporting it and the stock-related data reflecting it. Here's her report:

(1) *Demand surges.* After Covid-19 hit US shores, durable goods orders dropped sharply, but briefly, in early 2020. But then orders quickly rebounded and proceeded to surge far beyond historical levels. Nondefense capital goods orders excluding aircraft rose to $950 billion in December, up 10.6% y/y and far outpacing the last recent peak of $825 billion in July 2018 (*Fig. 3*).

Within durable goods, orders for machinery have been particularly strong, soaring to $460 billion in December, up from $379 billion in December 2019 and even up from $388 billion in December 2018 (*Fig. 4*).

And within the machinery category, the extremely sharp rise in orders for industrial machinery stands out. Industrial machinery orders were $71 billion in December, up 89% y/y and far higher than they stood in 2019. In fact, orders for industrial machinery are nearly double the level at the end of 2019 (*Fig. 5*).

Manufacturers have strained over the past year to meet the surge in demand, in part because manufacturing capacity growth has stalled since roughly 2001, when China joined the World Trade Organization. The last two decades have been a departure from history, when manufacturing capacity grew by roughly 3.9% annually (*Fig. 6*). If demand for durable goods manufactured in the US remains high, capacity additions should follow.

(2) *Insights from Rockwell.* One company feeling multiple effects from the Manufacturing Renaissance is Rockwell Automation, as it makes both the equipment and the software involved with automating manufacturing lines.

In a January 27 *conference call*, CEO Blake Moret noted that Rockwell's December quarter saw significant demand from domestic manufacturers in diverse industries—including EVs and batteries, food and beverages, tires, and e-commerce fulfillment centers—as well as global semiconductor manufacturers in expansion mode. Semi manufacturers planning capacity expansions in the US will have to build an "ecosystem of local partners" to support their semiconductor manufacturing plants. "[E]veryone is trying to come out of the pandemic better positioned than their competitors in terms of capacity and new offerings," said Moret.

As a buyer of semiconductors, Rockwell is still experiencing "bottlenecks." Organic sales—which the company forecasts will rise 14%-17% in fiscal 2022 (ending September)—would have been higher in the December quarter were it not for supply-chain constraints. Adjusted earnings per share are expected to grow roughly 15% in fiscal 2022.

(3) *Stocks not so sure.* Despite the Manufacturing Renaissance, stocks in the S&P 500 Industrial Machinery and S&P 500 Electrical Components & Equipment industries have fallen sharply ytd through Tuesday's close, by 13.9% and 12.3%, respectively (*Fig. 7* and *Fig. 8*). That's a steeper ytd drop than the S&P 500 Industrials sector's 8.1% decline or the S&P 500's 9.7% loss. Rockwell shares, which are in the S&P Electrical Components & Equipment industry, have fallen 24.3% ytd and are 8.2% higher y/y.

It's likely that stocks in these industries ran too far, too fast over the past two years, leaving them open to the current pullback. While further sell-offs can't be ruled out, more serious losses should be prevented by strong future earnings growth.

The Electrical Components & Equipment industry's stock price index gained 21.1% last year, and its forward P/E peaked at 26.3 in July 2021. The forward P/E has since fallen to 21.3, which still leaves it near the top end of its forward P/E range over the past 25 years (*Fig. 9*). The shares should be buoyed by earnings, which analysts forecast will grow 26.2% in 2021, 16.8% in 2022, and 10.5% in 2023 (*Fig. 10*).

The same pattern appears in the S&P 500 Industrial Machinery industry. The industry's stock price index gained 21.4% last year, and its forward P/E peaked at 24.4 in November 2020 before settling down to 19.9 recently (*Fig. 11*). Once again, that's near the top end of the industry's forward P/E range over the past 25 years, but the shares should be supported by earnings, which analysts forecast will grow at double-digit clips: 27.8% in 2021, 11.3% in 2022, and 10.5% in 2023 (*Fig. 12*).

Disruptive Technologies: Crispr Breakthroughs. The current correction has not been kind to shares of companies conducting Crispr research. These companies are expected to lose money this year and for years to come as they spend on research.

Here are the returns ytd through Tuesday's close for the stocks of some of the industry's leading companies: Beam Therapeutics (-18.3%), Crispr Therapeutics (-26.6), Intellia Therapeutics (-28.8), and Editas Medicine (-34.5). Intellia's shares have posted a positive y/y return, 32.4%, but the shares of Beam (-32.5), Crispr (-58.9), and Editas (-69.5) all have fallen even more over the one-year time horizon.

While investors are selling, scientists at these companies and elsewhere continue to work on harnessing Crispr technology to treat disorders including Alzheimer's, tick-borne diseases, and blindness. Let's take a look at some of their advancements:

(1) *Crispr fights Alzheimer's.* Among Icelanders, there's a rare mutation that reduces the risk of Alzheimer's disease and has no known disadvantage. So researchers in Canada used Crispr to insert that genetic mutation into human cells in hopes that it will prevent Alzheimer's disease from occurring or slow its progression.

Alzheimer patients' brains have amyloid plaques that kill brain neurons. For the scientists in our readership, here's an explanation from a February 15 *article* in *Drug Target Review*: "These plaques are formed when the amyloid precursor protein is cleaved by an enzyme called beta-secretase. 'The Icelandic mutation makes it harder for this enzyme to cleave the amyloid precursor protein. As a result, the formation of amyloid plaques is reduced,'" said a researcher involved.

Treatment could target people in families that have the hereditary form of Alzheimer's, which affects patients as young as 35 to 40. It could also be used at the earliest signs of the disease, which in most patients occurs at age 65 or later.

Researchers still need to determine how to edit the mutation into millions of brain cells, and some are considering using non-infectious viruses. To that end, researchers from the Université Laval Faculty of Medicine and CHU de Québec-Université Laval Research Centre are studying mice with Alzheimer's disease and subsequently hope to conduct a small study on people with the mutation for early onset Alzheimer's.

(2) *Crispr fights Lyme disease.* Scientists are hoping to use Crispr technology to prevent ticks from infecting humans with diseases, like Lyme disease and Rocky Mountain spotted fever, a February 16 *article* in *Genetic Engineering & Biotechnology News* reported.

To do so, scientists first had to determine how to insert edited genes into tick embryos. They were thwarted by the hard coating on tick eggs that can shatter glass needles. So scientists at the University of Nevada removed the gland in female ticks that produces the hard egg coating. The eggs produced were permeable, allowing scientists to insert genes into the tick embryos.

(3) *Crispr enjoys more wins.* Scientists have treated at least 45 patients with sickle cell disease and beta thalassemia by editing their genes using Crispr technology, and it has worked in at least 22 of them, a December 31 NPR *article* reported.

The process entails removing cells from patients' bone marrow, gene-editing them using Crispr, then injecting them back into patients. The edited cells produce a protein that alleviates the symptoms of sickle cell. Vertex Pharmaceuticals and CRISPR Therapeutics developed the treatment, for which they hope to seek Food and Drug Administration approval within the next two years.

Doctors at the Oregon Health and Science University used Crispr on seven patients with Leber congenital amaurosis, a severe form of vision loss caused by a genetic mutation. Instead of withdrawing cells from the patient, treating them in a lab, and reinserting them into the patient as usually done, they injected a virus carrying the Crispr editor directly into patients' retina cells, which can't be taken out of the body.

Once Crispr was inside the retina cells, scientists believe it cut out the genetic mutation that caused the disease and restored vision by reactivating dormant cells, September 29 NPR *article* reported. While not completely cured, some patients' eyesight improved significantly, and scientists were given permission to work with another group of patients. They're now hopeful that this technique can be used on other cells that can't be removed from the body for treatment, such as brain cells.

Calendars

US: Thurs: Real GDP & GDP Price Deflator 7.0%/6.9%; PCE Headline & Core PCED (Q4) 6.4%/4.9%; Initial & Continuous Jobless Claims 235k/1.58m; New Home Sales; Kansas City Fed Manufacturing Index; Chicago Fed Manufacturing Index; Natural Gas Storage; Crude Oil Inventories; Mester; Waller. **Fri:** Durable Goods Orders Headline, Excluding Defense, and Core Capital Goods Orders 0.8%/0.1%/0.5%; Personal Income & Consumption -

0.3%/1.5%; Core PCED 0.5%m/m/5.1%y/y; Consumer Sentiment, Headline, Current Conditions, and Expectations 61.7/68.5/57.4; University of Michigan One- & Five-Year Inflation Expectations 5.0%/3.1%; Pending Home Sales 1.0%; Baker-Hughes Rig Count; Fed Monetary Policy Report. (Bloomberg estimates)

Global: **Thurs:** France Business Confidence 100; UK Gfk Consumer Confidence -18; McCaul; Schnabel; Bailey. **Fri:** Eurozone Business & Consumer Survey 113.1; Germany GDP -0.7%q/q//1.4%y/y; France GDP 0.7%q/q/5.4%y/y; France CPI; Italy Consumer & Business Climate Index 115.0/113.9; Japan Leading & Coincident Indicators; Eurogroup Meetings; Lagarde; McCaul. (Bloomberg estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) remained below 2.00 this week for the seventh straight week and the 11th time in 12 weeks. It fell this week for the sixth time in seven weeks, from 2.15 to 1.04 over the seven-week period—the lowest since early April 2020. Bullish sentiment fell for the sixth time in seven weeks, by 18.4ppts over the period, to 32.2% this week—the fewest bulls since early April 2020—after rising 10.8ppts (to 50.6% from 39.8%) over the prior three weeks. Meanwhile, the correction count fell for the second week to 36.8% this week after climbing the prior five weeks by 14.1ppts (40.0 from 25.9) to its highest percentage since early March 2020. Bearish sentiment moved higher for the third week from 25.0% to 31.0% over the period—the highest percentage since May 2020. The AAII Ratio fell to 30.8% last week after climbing the prior two weeks from 30.4%—which the lowest since late July 2020—to 40.7%. Bullish sentiment slipped for the second week to 19.3% last week after advancing from 21.0% to 26.5% the prior two weeks, while bearish sentiment rose to 43.2% after falling the prior two weeks from 52.9% to 35.5%.

S&P 500 Sectors Net Earnings Revisions (*link*): The S&P 500's NERI weakened m/m in February after rising in January for the first time in six months. It dropped to a 19-month low of 5.1% from a three-month high of 8.0% in January, but was positive for a 19th month following 13 straight negative readings. That exceeds the prior 18-month positive streak during the cycle that ended October 2018, when NERI reached a then tax-cut-induced record high of 22.1% in March 2018. February's reading compares to a record-high 23.1% in July 2021 and an 11-year low of -37.4% in May 2020. Eight of the 11 S&P 500 sectors had positive NERI in February, down from nine a month earlier and the lowest count since it was zero in July 2020. Four sectors had NERI readings at post-pandemic 19-month lows during the month. Just two had NERI improve m/m, down from four rising in January. Among the underperforming sectors, Materials turned negative m/m, Utilities was negative for a second month, and Communication Services for a fourth month. Here are the February NERIs for the S&P 500 and its sectors compared with their January readings: Energy (17.5% in February [13-month low], down from 23.7% in January), Financials (13.9, 21.0), Information Technology (10.5, 10.2 [17-month low]), Consumer Discretionary (5.5 [19-month low], 8.7), S&P 500 (5.1 [19-month low], 8.0), Real Estate (4.0 [10-month low], 5.2), Health Care (2.4 [19-month low], 4.7), Materials (-3.8 [19-month low], 4.2), Industrials (1.6, 4.1), Consumer Staples (2.3, 1.3), Utilities (-2.1, -1.0), and Communication Services (-9.6 [19-month low], -4.1).

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin was steady at a record high of 13.3% last week. Since the end of April 2020, it has exceeded its prior record high of 12.4% in September 2018. It's now up 3.0ppts from 10.3% during April 2020, which was the lowest level since August 2013. Forward revenues improved to less than 0.1% below its record high in early February, and forward earnings per share was back at a record high. They have both been making new highs since the beginning of March 2021 after peaking just before Covid-19 in February 2020. Since the Q2-2021 earnings season came in way better than expected, analysts have been playing catch-up with their lowball estimates from the Covid-19 shutdown period. Prior to this catch-up period, consensus S&P 500 forecasts had been falling at rates paralleling the declines during the 2008-09 financial crisis. Forward revenues growth rose 0.3ppt w/w to 7.8%, and remains above its 12-month low of 7.1% from early December. That's down from a record high of 9.6% growth at the end of May 2021. Still, that's up from 0.2% forward revenues growth during April 2020, which was the lowest reading since June 2009. Forward earnings growth rose 0.2ppt to 8.9%. It remains above its 16-month low of 8.2% in early December. That's down from its 23.9% reading at the end of April 2021, which was its highest since June 2010, and up substantially from its record low of -5.6% at the end of April 2020. Analysts' revisions to their forecasts for 2022 revenues and earnings are edging higher now, and so is the imputed profit margin estimate that we calculate from those forecasts. They expect revenues to rise 8.6% (up 0.4ppt w/w) in 2022 and 5.5% in 2023 (unchanged w/w) compared to preliminary 16.3% (down 0.2ppt w/w) gain reported in 2021. They expect earnings gains of 8.9% in 2022 (up 0.2ppt w/w) and 9.9% in 2023 (down 0.1ppt w/w) compared to a preliminary earnings gain of 51.3% in 2021 (up 0.1ppt w/w). Analysts expect the profit margin to stall y/y in 2022 at 13.2% (unchanged w/w) compared to a preliminary 13.2% in 2021 (up 0.1ppt w/w) and to improve 0.5ppt y/y to 13.7% in 2023 (down 0.1ppt w/w). The S&P 500's weekly reading of its forward P/E dropped 0.6pt w/w to 19.7, barely up from a 21-month low of 19.5 at the end of January. That's down from an eight-month high of 21.7 at the end of 2021 and compares to 23.1 in early September 2020, which was the highest level since July 2000 and up from a 77-month low of 14.0 in March 2020. The S&P 500 weekly price-to-sales ratio of 2.70 was down 0.07pt w/w to 2.63, also barely up from an 11-month low of 2.59 at the end of January. That's down from a record high of 2.88 at the end of 2021 and a 49-month low of 1.65 in March 2020.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins (*link*): Last week saw consensus forward revenues and earnings rise for nine of the 11 S&P 500 sectors and the forward profit margin increase for seven sectors. Nearly all sectors are at or near record highs in their forward revenues, earnings, and profit margins. Energy still has forward revenues and earnings well below record highs, but its profit margin is near its highest reading since November 2008. Financials, Real Estate, and Utilities have forward earnings at or near record highs, but their forward revenues and margins are lagging. Only three sectors posted a higher profit margin y/y in 2020: Consumer Staples, Tech, and Utilities. For 2021, all but the Utilities sector posted a y/y improvement. Five sectors are expected to see margins decline or remain flat y/y in 2022: Communication Services, Consumer Staples, Financials, Materials, and Real Estate. Here's how they rank based on their current forward profit margin forecasts along with their record highs: Information Technology (25.3%, a record high this week), Communication Services (16.4, down from its 17.0 record high in October), Real Estate (16.9, down from its 19.2 record high in 2016), Utilities (14.6, down from its 14.8 record high in April 2021), Materials (13.1, down from its 13.4 record high in December), S&P 500 (13.3, a record high this week), Health Care (11.5, a new record high this week), Industrials (10.2, down from its 10.5 record high in December 2019), Consumer Staples (7.6, down from its 7.7 record high in June), Consumer Discretionary (8.1, down from its 8.3 record high in 2018), and Energy (9.3 [13-year high], down from a record-high 11.2 in 2007).

S&P 500 Sectors Forward Revenues and Earnings Recovery from Covid-19 Trough (*link*): The S&P 500's forward revenues and earnings as well as its implied forward profit margin bottomed at cyclical lows on May 28, 2020 after 14 weeks of Covid-19-related declines. Forward revenues and earnings have risen 24.8% and 62.4%, respectively, to record highs since February 2021. The forward profit margin has risen 3.3ppts to a record high of 13.3%. That exceeds its prior pre-Covid record of 12.4% in late 2018. During the latest week, consensus forward revenues and earnings rose for nine of the 11 S&P 500 sectors, and the forward profit margin gained for seven sectors. Here's how the S&P 500 and its 11 sectors rank by their changes in forward revenues and forward earnings since May 28, 2020: Energy (forward revenues up 50.9%, forward earnings up 2,357.9%), Materials (37.7, 105.2), Information Technology (32.7, 54.2), Industrials (28.2, 78.2), Communication Services (26.9, 56.0), S&P 500 (24.8, 62.4), Financials (22.4, 68.9), Health Care (19.9, 37.7), Consumer Discretionary (18.9, 105.4), Real Estate (16.1, 38.3), Consumer Staples (15.6, 22.2), and Utilities (1.4, 6.3).

S&P 500 Q4 Earnings Season Monitor (*link*): With nearly 88% of S&P 500 companies finished reporting revenues and earnings for Q4-2021, revenues have beat the consensus forecast by 2.2% and earnings by 6.0%. The earnings surprise is substantially weaker than those seen since Q1-2020. At the same point during the Q3 season, revenues were 2.9% above forecast and earnings beat by 11.1%. For the 438 companies that have reported Q4 earnings through mid-day Wednesday, the aggregate y/y earnings growth rates have slowed considerably from their readings during Q2 and Q3, but revenues growth has remained strong. The Q4 reporters so far collectively has a y/y revenue gain of 15.2% and an earnings gain of 27.3%. Just 78% of the Q4 reporters so far has reported a positive earnings surprise, equal to the 78% that has beaten revenues forecasts. However, fewer companies have reported positive y/y earnings growth in Q4 (76%) than positive y/y revenue growth (87). These figures will not change much as more Q4-2021 results are reported in the coming weeks. The y/y growth rates have eased in Q4 compared to Q2 and Q3. The revenues and earnings surprises have eased q/q due to increased company guidance ahead of the earnings season as well as supply-chain issues that have resulted in missed deliveries and higher costs.

Global Economic Indicators

Eurozone CPI (*link*): The headline CPI accelerated for the seventh month, from 1.9% last June to a record-high 5.1% y/y in January, matching its flash estimate. The rate was at -0.3% at the end of 2020. Looking at the main components, once again energy posted the largest gain, accelerating for the 13th time in 14 months to a record-high 28.8% y/y, up from -8.3% in November 2020. The rate for food, alcohol & tobacco reached a 21-month high of 3.5% y/y in January, rising steadily from June 2021's 0.5%, while the rate of non-energy industrial goods eased to 2.1% y/y after rising steadily from 0.3% last March to a record-high 2.9% by the end of the year. The services rate slowed for the second month to 2.3%, after soaring to 2.7% in November—which was the highest since summer 2008. The core rate eased to 2.3% y/y in January from 2.6% the final two months of 2021—which matched its record high in March 2002. Of the top four Eurozone economies, Spain's rate (6.2% y/y) was above the Eurozone's 5.1% pace, while France's (3.3) was below—and the lowest of all the Eurozone economies. Meanwhile, rates in both Germany and Italy matched the Eurozone's 5.1% rate.

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