MORNING BRIEFING
March 3, 2022

Sentiment, Retailers, China & Crypto

Check out the accompanying chart collection.

Executive Summary: Bargain buying now for the long term may make sense, suggests the Bull-Bear Ratio and lessons from past geopolitical shocks. A caveat: This time may be different given coming interest-rate increases and the potential for disrupted energy markets. … Retailers' recent earnings reports have been decidedly optimistic, but stock investors aren't convinced. Why are they spooked when the C-suite folks are sanguine? … China's President Xi may have a change of heart about former BFF Putin; we explain why we think so. … And: Cryptocurrencies' new wartime uses.

Strategy: Contrarian Perspective Update. The Bull-Bear Ratio (BBR) compiled by Investors Intelligence gave a screaming buy signal yesterday morning. Consider the following:

(1) *BBR flashes "buy" signal.* The latest reading of the BBR fell to 0.87 during the March 1 week from 1.04 the prior week (*Fig. 1*). Readings of 1.00 or less have had a very good record of calling bottoms in the S&P 500 stock price index as well as in the percentage of the S&P 500 stocks below their 200-day moving averages (*Fig. 2* and *Fig. 3*).

Notably, those readings don't rule out further near-term declines in the S&P 500. However, they do suggest that buying bargains now makes sense for long-term investors. From a contrarian perspective, extreme bearish sentiment tends to be extremely bullish.

(2) *What about the Ukrainian crisis?* Barry Ritholtz, our good friend and neighbor, has an excellent *article* this morning (March 2) on Bloomberg titled "History Shows War Shocks Have a Modest Impact on Equities." He writes:

"Historically, events such as wars, assassinations, and terror attacks are just not that meaningful to the factors that drive markets. These horrific events exact a terrible human toll, as measured in casualties and injuries, human suffering, and refugees. But the immediate reaction to dangerous mass conflicts like the war in Ukraine tends not to affect equity valuations over the long term. What drives equity prices are increased corporate revenue and profit, and the typical geopolitical event isn't big enough to change those very much. The impact on global gross domestic product is modest in all but a few outlier cases."

(3) *Be warned that this time might be different.* The Ukraine crisis is causing commodity prices to soar, which will push inflation even higher. It's unlikely that Fed Chair Jerome Powell will respond with a "Volker 2.0" tightening of monetary policy, but he has to start raising interest rates. In any event, the biggest risk for investors—having the potential to cause a recession and a bear market—is likely to be disruption in the energy markets, with soaring energy prices and energy shortages, particularly in Europe.

Consumer Discretionary: Retailers Sitting Pretty. Recent news about retailers' earnings has been decidedly optimistic. Target's managements' 2022 earnings-per-share forecasts imply percentage increases in the high single digits, which pleasantly surprised analysts. And Kohl's management is so confident about the future that it's increasing the company's dividend 100%, while Nordstrom plans to reinstate its dividend.

Investors aren't convinced. While some of the retailers' shares popped this week, the S&P 500 retailing industries stock price indexes are down sharply ytd. Here are some of their ytd returns through Tuesday's close: Home Improvement Retail (-20.4%), Apparel Retail (-17.4), Specialty Stores (-16.4), Drug Retail (-13.3), Automotive Retail (-12.3), Internet & Direct Marketing Retail (-9.9), General Merchandise Stores (-7.1), and Hypermarkets & Super Centers (-7.0) (*Fig. 4*, *Fig. 5*, and *Fig. 6*).

Let's take a look at what's spooking investors and what the C-suite folks are seeing that makes them confident nonetheless:

(1) *Soaring prices.* Prices were rising prior to the Ukraine war, and now they're really cooking. The price of Brent crude oil futures rose from its 2020 low of $19.33 per barrel to $77.78 at year-end 2021 as the economy rebounded from Covid-19's impact. The outbreak of war in Ukraine and the related sanctions on Russia sent the price of oil higher still, to $104.97 as of Tuesday (*Fig. 7*).

OPEC disappointed the markets at its meeting this week by not increasing output any faster than was already planned. But we expect that US producers, lured by profits or prodded by the President, will increase production. US producers are pumping about one million fewer barrels per day of crude oil than they were in 2019 (*Fig. 8*).

Oil isn't the only commodity with prices on the rise. The CRB Metals spot price index is at an all-time high, with copper prices near their recent highs and palladium prices 35% higher ytd (*Fig. 9*, *Fig. 10*, and *Fig. 11*). Russia is a key exporter of palladium.

Food prices are climbing as well, as war-torn Ukraine is a major exporter of grains and oil seeds. The price of wheat futures is at a decade high, having risen 22% ytd, and corn and soybean futures are also close to recent highs (*Fig. 12*, *Fig. 13*, and *Fig. 14*). Trips to the grocery store may be even pricier this year than they were in 2021.

(2) *Jobs plentiful.* If consumers have jobs and wages rise, in theory they should be able to keep shopping even if purchase prices rise to accommodate higher commodity prices. The latest good news on the jobs front came yesterday when ADP reported that companies added 475,000 jobs in February, better than expected, and sharply revised upwards its January report, from a loss of 301,000 jobs to a gain of 509,000.

Large companies (500 or more workers) added 552,000 jobs last month, while small shops (50 or fewer) recorded a loss of 96,000 jobs, ADP reported. The Labor Department's job report for February is slated for release on Friday.

(3) *Nordstrom is raising prices, cutting costs.* Some of Nordstrom's optimism is driven by the strength it's seeing in its southern and suburban stores. Sales in southern locations outperformed those in northern stores by 7ppts, and suburban locations outperformed urban locations by 10ppts. As people return to work, underperforming areas should catch up. "These locations are some of our biggest stores. So we see some opportunities," said CEO Erik Nordstrom.

Nordstrom plans mid-single-digit average retail price increases, leading to merchandise margin improvement. To offset rising prices in fulfillment and labor costs, the company is "optimizing" its supply chain to drive up efficiencies and drive down costs. Overall, that should result in 5%-7% revenue growth this year, an improvement in margins, and earnings per share of $3.15-$3.50, well above the $2.00 analysts had been expecting. The shares jumped 37.8% on Wednesday.

China: Between a Rock and a Hard Place. China President Xi Jinping called Russia's President Vladimir Putin his best friend during Xi's visit to Moscow in 2019. And the two leaders declared that there were no limits to their strategic partnership when Putin attended the Winter Olympics' opening ceremonies in China just last month.

So when Russia initially invaded Ukraine, it wasn't surprising that a Chinese foreign ministry spokeswoman downplayed the gravity and misplaced the blame. She did not describe the invasion as a violation of the country's sovereignty. She called the US the "culprit" for "heightening tensions, creating panic and even hyping up the possibility of warfare," a

March 1 *FT* *article* reported. Last Friday, China, the United Arab Emirates, and India abstained from a UN resolution condemning Russia's Ukraine invasion.

But on Tuesday, Chinese officials started to change their tune. A Chinese statement said that the country was "extremely concerned about the harm" to Ukrainian civilians and that China looked forward to playing a role in realizing a ceasefire. Ukrainian foreign minister Dmytro Kuleba "said his Chinese counterpart had assured him 'of China's readiness to make every effort to end the war on Ukrainian soil through diplomacy, including as a permanent member of the UN Security Council.'"

We wouldn't be surprised if behind the scenes China has started pushing Russia to end its incursion into Ukraine. A complete change of heart could occur quickly, as the nation's annual meetings of its parliaments begin on March 4 to lay out major policy initiatives. Let's have a look at several potential drivers of China's change in stance:

(1) *US and EU buy lots of Chinese exports.* When in doubt, follow the money. And in the case of China, take a look at the country's exports.

China needs the rest of the world to buy its goods. China's real GDP growth has slowed from 12.2% y/y during Q1-2010 to 4.0% during Q4-2021 (*Fig. 15*). Trade remains an important source of China's growth. Net exports accounted for 21% of the growth in GDP last year, one of the strongest readings, excluding the pop coming out of the 2020 recession (*Fig. 16*).

The US and the EU are the largest buyers of Chinese merchandise. The US purchased 17.8% of China's total merchandise exports in December, and the EU purchased 15.1%. Russia, however, purchased only roughly 2.5% of China's exports (*Fig. 17*).

(2) *High stakes for Xi.* China's reliance on exports has grown as overleveraged property developers—some of which have declared bankruptcy—have hurt property values and the economy. China Evergrande Group, with $300 billion of debt, is the poster child of this problem.

China has also experienced self-inflicted wounds to its economy lately, cracking down on a number of industries purportedly to protect individuals' lifestyles. President Xi also squashed Ant Financial's planned IPO after then-CEO Jack Ma criticized Chinese financial regulations. In addition to hurting economic activity, these moves have hurt Chinese stocks. The China MSCI stock price index has fallen 39% from its February 17, 2021 peak (*Fig. 18*).

Xi cannot afford any costly blunders, as he's hoping to be named president for a third term at the Communist Party's National Congress this fall.

(3) *And then there's Taiwan.* One of Xi's goals has been to unify mainland China with Taiwan. "The complete reunification of our motherland is an aspiration shared by people on both sides of the Taiwan Strait," Xi said according to a Nikkei Asia *article* on January 1.

There has been speculation that Russia's incursion into Ukraine would embolden China to attempt an invasion of Taiwan. In recent months, the country aggressively has flown its military jets near Taiwan's airspace and its military ships have sailed past the much smaller nation.

Xi no doubt is thinking of Taiwan as he watches Western countries' swift reaction to Russia's invasion of Ukraine. China has said that the two situations—Russia/Ukraine and China/Taiwan—are different because China has always considered Taiwan a part of China, even though Taiwan doesn't consider itself part of China. The US long has insisted that it would defend Taiwan in an attack by China. Hopefully, after watching the US (along with other countries) impose painful sanctions on Russia, China has no doubt that the US will act on its word.

Disruptive Technologies: Crypto War. Russia's invasion of Ukraine has been good for little except perhaps bolstering the price of bitcoin and other cryptocurrencies. Both Russia and Ukraine were active in the crypto markets before the war. Now their faltering currencies, along with the war sanctions on Russian interests, have increased trading volumes on the alternative financial system—and dependence on it.

Ukrainians are using cryptocurrencies to raise funding for the war, and the Russians are reportedly using it to sidestep financial sanctions. Individuals in both countries may be using cryptocurrencies to preserve their savings as local currencies dive.

The price of bitcoin has jumped 26% from its low on January 22 through Tuesday's close (*Fig. 19*). That's a sharp reversal from the major slide in the price of bitcoin that had been occurring since its November 8, 2021 peak of $67,634. And stable coins—which aim to maintain the value of one US dollar—were trading on Monday at 10%-13% premiums on Kuna, a crypto exchange used often in Ukraine. Conversely, the Russian ruble has tumbled 33% ytd, and the Ukraine hryvnia has dropped 7% (*Fig. 20* and *Fig. 21*). Trading volumes between the Russian ruble and bitcoin hit a nine-month high Monday as the ruble fell to record lows. There was also a spike in hryvnia-crypto trading volumes.

Let's take a look at how bitcoin is being used during this time of war:

(1) *Crypto for fundraising.* Ukraine has raised funds in traditional currencies to help fund its war efforts. The National Bank of Ukraine is accepting donations in US dollars, euros, UK pounds, and hryvnias. The country also sold this week in local currency $277 million worth of *war bonds* that yield 11%.

But what has received the bulk of media attention is the roughly $15 billion raised after a *Tweet* by the Ukrainian government asking for cryptocurrency donations in bitcoin, ethereum, and tether, a dollar-denominated stable coin. The funds are being used to support evacuees and provide the military with drones, heat-vision goggles, and gas, a March 1 CoinDesk *article* reported. And a handful of DAOs—decentralized autonomous organizations—and crypto billionaires have donated crypto funds to the country.

It's not surprising that Ukraine would turn to cryptocurrencies. Last year, Ukraine was ranked fourth in Chainalysis' *ranking* of 154 countries' cryptocurrency adoption. (The US was ranked 8th and the Russian Federation 18th.)

(2) *Crypto used to dodge sanctions.* Russia, its citizens, and its companies theoretically could sidestep some of the sanctions imposed upon them by using cryptocurrencies held in digital wallets and transacting on blockchain exchanges that are run separately from the world's banking institutions. Russian citizens reportedly have more than 12 million wallets to store cryptocurrencies.

To counter such activity, the Ukrainian government has called for crypto and blockchain platforms to block the addresses of Russian users. The Biden administration has asked crypto exchanges to monitor transactions that may be used by Russians to avoid sanctions, February 28 Bloomberg *article* reported.

Some exchanges have responded that they won't put a blanket hold on all Russian accounts, but a few will target accounts held by sanctioned individuals or organizations. Other crypto exchanges have made no such commitments. Some operate in countries without know-your-customer requirements or strong anti-money laundering rules, a March 1 *Barron's* *article* reported.

There are measures that users can take to avoid detection, like using Monero. This privacy coin runs on an encrypted blockchain; a crypto exchange might see Monero coming in, but it can't see the related counterparty transactions. There are also privacy wallets, like

Wasabi, which pool crypto assets to hide their origins.

Russia could use cryptocurrencies illegally reaped as part of ransomware attacks to help fund their war efforts. Almost three-quarters of global ransomware revenue in 2021 financed sources highly likely to be affiliated with Russia, according to Chainalysis data cited in a February 25 Decrypt *article*. The country also benefits from being the world's third-largest crypto miner, as it benefits from inexpensive, domestically sourced natural gas and hydroelectric power.

In his testimony before the House Financial Services Committee on Wednesday, Federal Reserve Chairman Jerome Powell noted that the potential use of cryptocurrencies to avoid sanctions in the Russian/Ukraine war "underscores" why there's a need for cryptocurrency regulation.

(3) *More crypto being used overall.* Before the Ukrainian war began, an increasing number of players had adopted cryptocurrencies. Institutional clients traded $1.14 trillion worth of cryptocurrencies on exchange Coinbase Global in 2021, up from just $120 billion the year before and more than twice the $535 billion for retail, a February 27 *WSJ* *article* reported. Institutions that buy bitcoin will have to ask themselves whether they are unintentionally helping the Russian cause.

Calendars

US: **Thurs:** Productivity & Unit Labor Costs 6.7%/0.3%; Initial Jobless Claims 226k; ISM NM-PMI 61.0; Factory Orders 0.5%; Natural Gas Storage; Powell; Williams. **Fri:** Payroll Employment Total, Private, and Manufacturing 400k/378k/20k; Unemployment Rate 3.9%; Average Hourly Earnings 0.5%m/m/5.8%y/y; Average Weekly Hours 34.6; Motor Vehicle Sales 15.0mu; Baker-Hughes Rig Count. (Bloomberg estimates)

Global: **Thurs:** Eurozone, Germany, and France, C-PMIs 55.8/56.2/57.4; Eurozone, Germany, France, Italy, and Spain NM-PMIs 55.8/56.6/57.9/52.5/51.4; Eurozone PPI 2.3%m/m/26.9%y/y; UK C-PMI & NM-PMI 60.2/60.8; Japan NM-PMI 42.7; Japan Unemployment Rate 2.7%; Australia Retail Sales; ECB Publishes Account of Monetary Policy Meeting; Enria; Tenreyro. **Fri:** Eurozone Retail Sales 1.5%m/m/9.5%y/y; Germany Trade Balance €7.1b; France Industrial Production 0.5%; Italy GDP 0.6%q/q/6.4%y/y. (Bloomberg estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) dropped below 1.00 this week for the first time since early April 2020. It fell this week for the seventh time in eight weeks, from 2.15 to 0.87 over the period—the lowest since March 2020. Bullish sentiment fell for the seventh time in eight weeks, by 20.7ppts over the period, to 29.9% this week—the fewest bulls since the start of 2019—after rising 10.8ppts (to 50.6% from 39.8%) over the prior three weeks. Meanwhile, the correction count fell for the third week this week to 35.6%, 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 fourth week from 25.0% to 34.5% over the period—the highest percentage since April 2020. The AAII Ratio made a round trip in recent weeks, falling for the second week last week to 30.4% after climbing the prior two weeks from 30.4%—which the lowest since late July 2020—to 40.7%. Bullish sentiment climbed to 23.4% last week after slipping the prior two weeks from 25.6% to 19.3%, while bearish sentiment climbed for the second week from 35.5% to 53.4% over the period.

S&P 500 Q4 Earnings Season Monitor (*link*): With over 97% of S&P 500 companies finished reporting revenues and earnings for Q4-2021, revenues have beat the consensus forecast by 2.5% and earnings by 5.8%. The earnings surprise is substantially weaker than those seen since Q1-2020. At the same point during the Q3 season, revenues were 2.8% above forecast and earnings beat by 10.8%. For the 486 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 15.8% and an earnings gain of 29.0%. Just 76% of the Q4 reporters so far has reported a positive earnings surprise, slightly below the 77% that has beaten revenues forecasts. Furthermore, substantially fewer companies have reported positive y/y earnings growth in Q4 (75%) than positive y/y revenue growth (88).

US Economic Indicators

ADP Employment (*link*): “Hiring remains robust but capped by reduced labor supply post-pandemic. Last month large companies showed they are well-poised to compete with higher wages and benefit offerings, and posted the strongest reading since the early days of the pandemic recovery" said Nela Richardson, chief economist, ADP. "Small companies lost ground as they continue to struggle to keep pace with the wages and benefits needed to attract a limited pool of qualified workers." Private payroll employment advanced 474,000 in February—though the real shocker is that January's 301,000 drop was revised to a 509,000 gain, a swing of 810,000! Private payrolls is now up 19.5 million since the recovery began and within 295,000 of pre-Covid 19 levels. ADP's employment report showed widespread gains, with service-providing companies adding 417,000 jobs and goods-producing 57,000. Leisure & hospitality (170,000) led gains among service-providing industries, followed by trade, transportation & utilities (98,000), professional & technical services (40,000), health care & social assistance (38,000), and administrative & support services (29,000). Within goods-producing, both manufacturing (30,000) and construction (26,000) continued to post impressive gains. Here's a tally of industry performances from strongest to weakest since bottoming in April 2020 and relative to February 2020 levels: leisure & hospitality (+6.9 million, -747,000), trade transportation & utilities (+3.7 million, +667,000), health care & social assistance (+2.0 million, -56,000), administrative & support services (+1.6 million, +140,000), manufacturing (+1.3 million, -22,000 construction (+1.2 million & +242,000), other services (+1.1 million, -211,000), professional & technical services (+957,000, +454,000), education (+410,000, -38,000), financial activities (+289,000, +34,000), information services (+202,000, -41,000), management of companies & enterprises (+32,000, -50,000), and natural resources & mining (-23,000, -76,000). Here's the same exercise by company size: large (+8.9 million, -211,000), small (+5.7 million, +358,000), and medium (+5.0 million, +148,000).

Global Economic Indicators

Eurozone CPI Flash Estimates (*link*): The headline CPI is expected to accelerate for the eighth straight month, from 1.9% last June to a record-high 5.8% y/y in February. The rate was at -0.3% at the end of 2020. Looking at the main components, once again energy is expected to post the largest gain, accelerating for the 14th time in 15 months to a record-high 31.7% y/y, up from -8.3% in November 2020. The rate for food, alcohol & tobacco is forecast to reach 4.1% y/y in February (highest since October 2008), rising steadily from June 2021's 0.5%, while the rate of non-energy industrial goods is expected to accelerate to 3.0% (highest since mid-1993) after easing from 2.9% to 2.1% in November. The services rate is forecast to pick up to 2.5% y/y in February, from 2.3% in January, closing in on November's 2.7%—which was the highest since summer 2008. The core rate is predicted to accelerate to 2.7% y/y in February—the highest since the mid-1990s. Of the top four Eurozone economies, rates for Spain (7.5% y/y) and Italy (6.2) are expected to be above the headline rate of 5.8%, while rates for Germany (5.5) and France (4.1) are below.

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