MORNING BRIEFING
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TINAC: There Is No Alternative Country

Check out the accompanying chart collection.

Executive Summary: Why is the stock market defying the gravity of extremely grave situations? "TINA" may hold the answer: "There is no alternative" to stocks. … But now she's been joined by "TINAC"—"there is no alternative country." Global investors may be taking refuge in the US stock market as a safe haven in an unsafe world. … Today, we comparison-shop equity markets around the world and conclude that foreign stocks are cheaper but for several good reasons. … And: We look at why the US dollar is strong at a time of soaring commodity prices when usually the reverse is true.

Strategy I: TINA. "TINA" is the acronym for "there is no alternative" to owning stocks because other assets' potential returns just don't compare. TINA is often used to explain why stock valuation multiples have soared in recent years and why they might stay elevated. Sure enough, just before the start of the current bull market, the forward P/E of the S&P 500 rose from just 8.9 near the end of 2008 to peak at 23.6 during September 2020 (*Fig. 1*). It dropped to 18.2 in mid-March but was back up to 19.5 last Friday.

That's really quite impressive given that inflation has soared over the past year. So far this year, the Fed has turned increasingly hawkish, bond yields and mortgage rates have soared, and Russia's horrible invasion of Ukraine has put upward pressure on commodity prices. The war and China's latest outbreak of Covid-19 are continuing to exacerbate global supply-chain disruptions. Yet the S&P 500's valuation multiple remains historically high, as though stock investors hadn't a care in the world. The same can be said for the index's forward price-to-sales ratio. Can TINA explain why? Let's have a closer look:

(1) *Bonds versus stocks.* From the mid-1950s up until the Great Financial Crisis of 2008, the 10-year US Treasury bond yield always exceeded the S&P 500's dividend yield (*Fig. 2*). Since then, the bond yield has fluctuated around the dividend yield. TINA got a big boost following the lockdown recession of 2020, when the bond yield fell to a record-low 0.52% on August 4. But even as yields have climbed since then, bonds still haven't been an attractive alternative to stocks because bonds have incurred substantial capital losses. If the bond yield stabilizes around 2.50%-3.00% for a while, then TINA might have some serious competition.

(2) *Fund flows.* Over the past 12 months through February, equity ETFs had a net inflow of $692.8 billion, down slightly from the record pace during December (*Fig. 3*). That has more than offset the $217.5 billion net outflow from equity mutual funds over the same period. So the total net inflow into equity funds of both types combined over the 12 months through February was $475.3 billion, just below January's record. The monthly data have been showing net inflows into equity funds since November 2020, barring one month (*Fig. 4*).

Bond mutual funds had a net outflow during February of $27.6 billion, more than offsetting the $10.6 billion net inflow to bond ETFs (*Fig. 5*). January also saw a small net outflow from bond funds for the first time since the massive exodus that occurred during March 2020.

By the way, while money poured into equity funds following the lockdown recession of March and April 2020, it also poured into bond funds (*Fig. 6*). In fact, the 12-month inflow hit a record high of $1.0 trillion through April 2021. It was down to $489.8 billion through February of this year. In other words, bonds in fact have been used as an alternative to stocks over the past two years.

Strategy II: TINAC. Tireless stock market cheerleader TINA might be getting an assist from her sister "TINAC," which stands for "there is no alternative *country*."

Let me explain: The US has turned into a safe haven for global investors in a world that has become increasingly less safe. We have data through January on net capital inflows from overseas provided in the US Treasury International Capital System. It shows $874.6 billion in net securities purchased by foreigners from US residents over the past 12 month (*Fig. 7*). It also shows that foreigners sold $14.5 billion in US corporate stocks over the 12 months through January. But recent unsettling geopolitical events might attract more global investors to purchase US securities, including equities.

As we discussed in yesterday's *Morning Briefing*, the Ukraine war poses a greater recession risk to Europe than to the US, in our opinion. The war has caused global shortages of grains as well as fertilizer. As a result, food prices are soaring. The FAO Food Price Index averaged 159.3 points in March 2022, a new record high since the series' inception in 1990 and representing a giant 17.9-point (12.6%) leap from its February level (*Fig. 8* and *Fig. 9*). The latest increase reflects new all-time highs for the vegetable oils, cereals, and meat sub-indexes, while those of sugar and dairy products also rose significantly.

Rapidly rising food and fuel prices could spark social upheaval around the world reminiscent of the 2010 Arab Spring riots, especially in emerging economies. Meanwhile, the Chinese government once again has resorted to lockdowns in response to Covid-19 outbreaks as well as continues to saddle businesses with onerous new regulations.

Against that backdrop, the US looks like a safe haven from the turmoil around the world. That's already reflected in valuation multiples, which are uniformly lower overseas compared to the US. Foreign stocks may look cheaper, but they are so for lots of good reasons. Let's comparison-shop equity markets around the world:

(1) *Relative performance.* The ratio of the US MSCI stock price index to the All Country World (ACW) ex-US remains on its solid uptrend line that started in 2009 (*Fig. 10*). It rose to a new record high last week with the denominator priced in dollars. Here is the performance derby of the major world MSCI stock price indexes since the start of the bull market in early 2009 through Friday, in dollars and in local currency: US (564.8%), ACW ex-US (136.6, 153.0), Emerging Markets (132.4, 159.5), European Monetary Union (EMU) (114.6, 149.4), Japan (113.4, 168.5), and the UK (99.2, 110.7).

(2) *Sectors.* It is widely assumed that the outperformance of the US MSCI is attributable to the Information Technology sector. That's not so. The outperformance is remarkably broad-based across all 11 sectors of the MSCI, as shown by the sector performances since March 5, 2009 for the US and the ACW ex-US (in dollars): Communication Services (197.5%, 41.3%), Consumer Discretionary (1,163.6, 186.5), Consumer Staples (283.3, 170.0), Energy (86.4, 19.6), Financials (548.0, 138.1), Health Care (550.6, 191.3), Industrials (552.6, 199.6), Information Technology (1,243.2, 456.4), Materials (416.3, 131.4), Real Estate (427.6, 87.1), and Utilities (213.4, 13.2). All 11 sectors in the US outpaced the comparable ones abroad. (See our *US MSCI vs All Country World ex-US MSCI* chart book.)

(3) *Forward revenues & earnings.* The rebound in MSCI forward revenues has been V-shaped in the US and more U-shaped overseas (*Fig. 11*). At the end of March, the former exceeded its pre-pandemic record high by 11.0%. The forward revenues of the ACW ex-US MSCI was up 0.2% over the comparable period. It's the same story for forward earnings (*Fig. 12*). It is up 24.7% from its pre-pandemic high for the US MSCI but 16.2% for the rest of the world.

(4) *Profit margins.* The US MSCI has a much higher forward profit margin (which we calculate from analysts' consensus estimates for revenues and earnings) than the rest of the world (*Fig. 13*). The US MSCI's forward profit margin has been in record-high territory for the past year; the latest reading, at the end of March, was 13.1%. The comparable

forward margins elsewhere include: ACW ex-US (8.9%), EMU (8.7), Emerging Markets (7.0), the UK (11.3), and Japan (7.5).

(5) *Valuation.* The ACW ex-US MSCI is strikingly cheap relative to the US MSCI. At the end of March, the former had a forward P/E of 13.4, while the latter had one of 20.5 (*Fig. 14*). At 0.65, the ratio of the former to the latter was among the lowest readings since at least 2002, when our data begin (*Fig. 15*).

The ACW ex-US tends to have less market-capitalization weight in tech-related stocks. So it makes more sense to compare its forward P/E to that of the S&P 500 Value index. The former traded at about a 5% discount to the latter from 2006-16 (*Fig. 16* and *Fig. 17*). The discount rose to 21% on Friday. The discount in recent days has been the biggest since December 2008.

Any way we slice and dice the data, foreign stocks are cheap relative to US stocks. But as we observed above, the discount may well be deserved.

Strategy III: The Mighty Dollar, Gold & the RCB. The Stay Home investment strategy has outperformed the Go Global alternative in both dollars and local currencies since 2009. The ACW MSCI index currency ratio is the local currency index divided by its US dollar index (*Fig. 18*). This ratio closely tracks the JP Morgan trade-weighted dollar. The ratio, which tends to be volatile, is up 16.5% from its low in early 2011 through Friday's close.

A strong dollar has favored overweighting the US in a global stock portfolio. Overweighting foreign stocks was the way to go from 2002—after China joined the World Trade Organization on December 11, 2001—through 2007. The dollar was very weak during those years, and the ACW ex-US MSCI outperformed the US MSCI in both dollars and local currencies.

What's puzzling currently is the strength of the dollar in the face of soaring commodity prices. In the past (since 1994, at least), there was a reasonably good inverse correlation between the two (*Fig. 19*). Why are they both strong now at the same time? Consider the following:

(1) *Peacetime.* Before the Ukraine war, the commodity cycle was driven by the global business cycle. When it was strong, commodity prices rose. Many commodity prices are priced in dollars. At times when foreign exporters of commodities enjoyed booming sales, they would tend to diversify their flood of dollars into other currencies. That would weaken

the dollar, which would boost demand by countries whose currencies were strong.

(2) *Wartime.* Currently, the strength of commodities certainly isn't reflecting a booming global economy but rather wartime disruptions in the supplies of agricultural, energy, and industrial commodities. At the same time, the US dollar is benefitting from TINAC.

(3) *Time for gold?* By the way, the price of gold tends to track the underlying trend in the CRB raw industrials spot price index, which is currently very bullish for gold (*Fig. 20*). On the other hand, the price of gold is inversely correlated with the 10-year TIPS yield, which currently is bearish for gold (*Fig. 21*).

A new development in the gold market is that the Russian Central Bank last week announced pegging the Russian ruble to the gold price. In addition, Russian President Vladimir Putin declared that foreign buyers are required to pay in rubles for gas purchased from Russia. India and even European countries—especially the smaller ones—-already have started to pay for Russian gas in rubles. As a result, the ruble has nearly completely recovered from its freefall after Western governments sanctioned Russia for invading Ukraine.

Calendars

US: Tues: Headline & Core CPI 1.2%m/m/8.5%y/y & 0.5%m/m/6.6%y/y; NFIB Small Business Optimism Index; OPEC Monthly Report; Federal Budget Balance -$49.5b; Brainard. **Wed:** Headline & Core PPI 1.1%m/m/10.6%y/y & 0.5%m/m/8.4%y/y; MBA Mortgage Applications; Crude Oil Inventories; IEA Monthly Report. (Bloomberg estimates)

Global: Tues: Eurozone Economic Sentiment; Germany CPI 2.5%m/m/7.3%y/y; Germany ZEW Economic Sentiment -48.0; UK Average Earnings Including & Excluding Bonus 5.4%/4.0%; UK Employment Change 3m/3m & Unemployment Rate 58k/3.9%; China New Loans & Total Social Financing; China M2; China Trade Balance ¥22.4b; Japan Core Machinery Orders -1.5%m/m/14.5%y/y; Japan M2 3.6%y/y; RBA Interest Rate Decision 1.25%. **Wed:** Eurozone Industrial Production 0.1%; Italy Industrial Production 0.7%m/m/1.4%y/y; Spain CPI 3.0%m/m/9.8%y/y; UK Headline & Core CPI 0.7%m/m/6.7%y/y & 0.5%m/m/5.4%y/y; UK PPI Input & Output 2.5%m/m/13.9%y/y & 1.2%m/m/11.1%y/y; BOC Interest Rate Decision 1.00%; Australia Employment Change 40k; Australia Unemployment & Participation Rates 3.9%/66.5%; Kuroda. (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 15th week after dropping for a week earlier due to index changes. MidCap's was at a record high for an 18th straight week after dropping 0.1% below at the end of November. SmallCap's rose for a fourth week and was at a record high for a second straight week. It had been steadily making new highs until mid-December, but then dropped 1.4% below its record by early March. In what has shaped up to be an extraordinary V-shaped recovery, LargeCap's forward earnings has risen during 94 of the past 98 weeks, with the down weeks due to Tesla's addition to the index in December 2020, Amazon's earnings shortfall last August, and index changes in September and December. MidCap's forward earnings is up in 92 of the past 96 weeks, and SmallCap's posted 89 gains in the past 97 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 65.7% from its lowest level since August 2017; MidCap's is now up 130.0% from its lowest level since May 2015; and SmallCap's has soared 189.1% 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 weakened to a 12-month low of 27.2% y/y from 27.9%; 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 rose to 40.9% y/y from 40.4% and is up from an 11-month low of 39.9% in late March. 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 rose to 46.4% y/y from a 12-month low of 46.2%. 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' consensus earnings forecasts for 2021 and 2022 to improve instead of decline as is typical. Here are the latest consensus earnings growth rates for 2022 and 2023: LargeCap (9.3%, 9.9%), MidCap (10.5, 8.4), and SmallCap (10.6, 12.5).

S&P 500/400/600 Valuation (*link*): Valuations fell across the board for these three indexes last week. LargeCap's forward P/E ticked down 0.3pts to 19.2 from 19.5. That's up from a 23-month low of 18.2 in early March and down from a six-month high of 21.5 in early November. LargeCap's forward P/E also compares to a 19-year high of 22.7 in January 2021 and is up from 13.3 in March 2020, which was the lowest since March 2013. MidCap's dropped 0.7pt w/w to a 24-month low of 13.7 from 14.4. That's down from a 13-week high of 17.1 in early November. That also compares to a seven-month high of 20.5 in March 2021 and is 8.5pts below its record high of 22.9 in June 2020. SmallCap's also fell 0.7pt w/w to a 24-month low, but to 13.1 from 13.8. That's down from a 13-week high of 16.1 in early November and is now down 13.4pts 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 29% discount to LargeCap is its biggest since September 2000. SmallCap's P/E was below LargeCap's for an 85th week. That's the longest stretch at a discount since 1999-2002; SmallCap's current 32% reading is its biggest discount since February 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 41st straight week; the current 5% discount is up from a 9% discount in December but remains near its lows during 2000-01.

S&P 500 Sectors Quarterly Earnings Outlook (*link*): Since the Q3-2020 earnings season, analysts as a whole have been raising their consensus forecasts for future quarters instead of lowering them as is the norm through the earnings warnings seasons. That six-quarter streak of positive revisions throughout the quarter has officially ended with Q1-2022. In the latest week, the Q1-2022 earnings-per-share forecast dropped 8 cents w/w to $51.46, and is down 1.5% from $52.22 at the start of the quarter. Analysts expect S&P 500 earnings growth to weaken substantially to 4.9% y/y on a frozen actual basis and 6.1% on a pro forma basis. That's down from Q4-2021's 26.9% y/y on a frozen actual basis and a 32.1% y/y gain on a pro forma basis. Double-digit growth is expected for just four sectors in Q1-2022, and three are expected to record a y/y decline. That compares to Q4-2021's count of eight sectors with double-digit growth and one sector with a y/y decline. Here are the S&P 500 sectors' latest earnings growth rates for Q1-2022 versus their Q4-2021 growth rates: Energy (239.2% in Q1-2022 versus 12,611.0% in Q4-2021), Industrials (37.1, 43.8), Materials (34.8, 64.2), Real Estate (17.5, 17.6), Health Care (9.7, 28.0), Information

Technology (8.6, 24.6), Utilities (6.4, -1.3), S&P 500 (6.1, 32.1), Consumer Staples (2.0, 7.7), Communication Services (-5.2, 16.6), Consumer Discretionary (-12.4, 54.1), and Financials (-22.9, 9.9).

Global Economic Indicators

UK GDP (*link*): Real GDP in February slowed to a near standstill, following January's bounce-back when the Omicron disruption eased. The Omicron variant and Plan B restrictions sent GDP south during the final month of 2021. Economic activity ticked up 0.1% in February following a 0.8% rebound in January and a 0.2% contraction in December, and is currently 1.5% above its pre-Covid level. Worth noting, the February data covered a period before the February 24 invasion of Ukraine. The manufacturing sector held back growth in January, sliding an unexpected 0.4% in February as supply-chain issues suppressed production in the car and computer sectors. Supply-chain disruptions have been further squeezed by sanctions and disruptions dealing with the war. While the manufacturing sector depressed growth in February, a rebound in tourism-related industries offset the weakness. The service sector, which accounts for roughly 70% of UK GDP, increased 0.2% in February, building on January's 0.8% gain. The service sector is 2.1% above its pre-pandemic level, while manufacturing is 0.7% below. Meanwhile, the construction sector dipped 0.1% in February following a three-month gain of 2.1%; it's 1.0% above February 2020.

UK Industrial Production (*link*): Production contracted 0.6% in February, after climbing 2.1% during the three months through January, while manufacturing output fell 0.3% and rose 2.6% over the comparable periods. Headline production was 1.9% below its pre-pandemic level in February, while manufacturing was 0.7% below. Looking at the main industrial groups, intermediate goods production slipped 0.9% in February after jumping 6.5% in January to a new record high. Output of capital goods sank 3.3% in February following a three-month gain of 5.4%; it's been bouncing in a volatile flat trend over the past 13 months. Consumer durable goods production sank 2.3% in February after soaring 7.9% during the three months through January—to its highest level since November 2019. Meanwhile, production of consumer nondurable goods rebounded 2.3% in February after plunging 5.6% in January from its record high at the end of 2021.

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