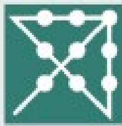

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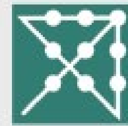

MORNING BRIEFING
April 14, 2022

Inflation, Semis, Banks & Grocery Shopping

Check out the accompanying chart collection.

Executive Summary: We've been on the lookout for signs of peak inflation, and we are deflated to report none to be seen in the latest PPI and small business survey releases. Instead, they telegraphed higher-for-longer inflation in a weakening stagflationary environment. … Semiconductor-related stocks have been beaten down ytd, but analysts expect double-digit earnings growth this year and next, aided by some fast-growing end markets. … Also: Expect smaller domestically focused banks to report stronger Q1 results than their big multinational counterparts. … And: Grocery shopping with no waiting in checkout lines or schlepping bags to the car? Yep: The supermarket industry is going high tech.

Inflation: No Peak in Latest Data. Debbie and I are on the lookout for peak inflation. Let us know if you see something. So far, all we see is that used car inflation might have peaked in March's CPI. Yesterday's PPI release showed that inflationary pressures continue to build. Furthermore, more small business owners raised their prices during March. We are still expecting inflation to peak by June or July, but higher inflation for longer is what the latest batch of price indicators is showing:

(1) *Small business owners raising prices.* The March survey of small business owners conducted by the National Federation of Independent Business (NFIB) found that a record 72% of them raised their selling prices, while 50% of them are planning to do so (*Fig. 1*). The percent of owners planning to raise worker compensation remained in recent record-high territory at 28% (*Fig. 2*).

The NFIB survey found that the percent of respondents agreeing that the outlook for general business conditions six months from now would be better rather than worse fell to a record-low -49% during March (*Fig. 3*). That might explain why the percent planning to increase hiring over the next three months fell from a record high of 32% last August to 20% during March (*Fig. 4*). The survey found that 31% of owners said that inflation is the single most important problem they face, up from 4% last March.

One word comes to mind to describe this sour economic outlook: "stagflation."

(2) *Producer prices inflating.* Two words come to mind to describe the March PPI data:

“rising inflation.” The PPI for final demand (PPI-FD) rose by 11.2% y/y, with goods up 15.7% and services up 8.7% (*Fig. 5*). These inflation rates are all at record highs! Leading the way in services was the 21.0% increase in transportation & warehousing services. The PPI-FD for construction was up 16.7%. There were no signs of peaks in either the headline or core PPI-FD for personal consumption, at 10.1% and 7.7% (*Fig. 6*).

Semiconductors: Time To Differentiate. After a banner 2021, technology stocks are having a tough start to 2022, with many industries in the sector seriously trailing the broader market as interest rates rise, P/E multiples contract, and investors grow fearful about a recession.

Here’s the performance derby for the S&P 500 sectors ytd through Tuesday’s close: Energy (41.2%), Utilities (6.4), Consumer Staples (1.8), Health Care (-1.7), Materials (-2.9), Financials (-4.6), Real Estate (-5.9), Industrials (-6.3), S&P 500 (-7.7), Consumer Discretionary (-13.5), Information Technology (-15.0), and Communication Services (-15.9) (*Table 1*).

The tech industries wallowing near the bottom of the performance derby include Semiconductor Equipment (-25.8%), Electronic Manufacturing Services (-25.5), Application Software (-24.3), Electronic Equipment & Instruments (-21.3), and Semiconductors (-21.2).

Semiconductor sales softened ever so slightly in February, according to the Semiconductors Industry Association. Worldwide sales increased 4.8% based on the three-month moving average, but not all regions improved: Asia/Pacific (19.2%), Europe (5.1), Americas (0.9), China (-2.2), and Japan (-2.8) (*Fig. 7*).

However, analysts are expecting respectable earnings growth for semiconductor companies in general this year. The S&P 500 Semiconductors industry is expected to grow earnings 12.9% this year and 11.9% in 2023 after a super-strong 2021, when the industry enjoyed 39.7% earnings growth (*Fig. 8*). The industry’s forward P/E has dropped to 18.1, down from the 25.0 hit in late November (*Fig. 9*).

Certain end markets for semiconductors are still growing fast and should do well even if PC sales slow this year. Electric vehicles (EVs), industrial automation, and servers and wireless communications should drive semiconductor sales for many years to come. Here’s a look at some of the factors affecting the industry’s earnings prospects:

(1) *Worries about slowing PC sales.* Consumers camped out at home throughout much of

the past two pandemic years purchased plenty of computers, phones, and gaming systems to stay connected with the office, learn from home, and stay entertained. This year, sales of PCs and cell phones have dropped off from Covid-inflated levels. Global shipments of desktops, notebooks, and workstations declined 5.1% y/y during Q1 after two years of double-digit growth, according to an April 11 IDC *press release*.

"We have witnessed some slowdown in both the education and consumer markets, but all indicators show demand for commercial PCs remains very strong. We also believe that the consumer market will pick up again in the near future," Ryan Reith, IDC group vice president with IDC's Worldwide Mobile Device Trackers, said in the announcement. The markets had already sniffed out a slowdown, as the prices of some memory chips have been declining modestly in recent months.

(2) *Chips in autos/factories still growing.* Investors focused solely on the PC market when judging the health of semiconductors may be shortsighted. The global semiconductor market is expected to see a 7% compounded annual growth rate from 2021 to 2030, but about 70% of the industry's growth comes from automotive, computation and data storage, and wireless, an April 1 McKinsey *report* states. There is twice as much semiconductor content in an EV than a traditional car with an internal combustion engine.

ON Semiconductor's business plan focuses explicitly on expanding the company's exposure to the fast-growing EV and the industrial markets, while reducing its exposure to other areas. Management expects 2021-25 compound annual growth rates of 17% in its auto segment revenue and 7% in its industrial segment revenue compared with a 1% average decline in other segments, according to the company's Q4 earnings *presentation*. The mix shift should help the company continue improving its gross margin. The company forecasts adjusted earnings per share of $0.98-$1.10 in Q1 compared to analysts' $0.82 consensus. The company's shares have fallen 21.8% ytd.

Other semiconductor companies are making acquisitions to boost their exposure to the faster-growing segments of the market. Advanced Micro Devices plans to buy Pensando Systems, which produces chips and software to speed data flow and lower operating costs for big server farms, for $1.9 billion. Qualcomm is purchasing a sensor and driving software platform from Veoneer, a Swedish company. And in December, Intel sold its memory chip business to Seoul-based SK Hynix.

(3) *Supplies in autos still tight.* Auto executives have continued to grumble about the tight supply of semiconductors. BMW CEO Oliver Zipse recently said that we are "still in the

height of the chip shortage" and that shortages would continue into 2023, a April 11 Reuters *article* stated, citing his interview in Neue Zuercher Zeitung. Volkswagen CFO Arno Antlitz said that although bottlenecks could begin to ease around year-end, chip supply won't completely satisfy demand until 2024, according to a April 9 Reuters *article*.

Daimler Truck said it was reducing production at some of its German factories in March and April due to a shortage of certain semiconductors, a March 28 Reuters *article* reported. And union officials at Italian factories producing Stellantis vehicles expect production to fall in 2022 for a fifth year due to the chip shortage, an April 6 Reuters *article* stated.

US motor vehicle sales sank 10.9% during the two months through March, which manufacturers blamed on low inventories and chip shortages (*Fig. 10*). The industry's inventory-to-sales ratio dropped to 0.37 in March, a record low (*Fig. 11*).

(4) *Expansion plans may be delayed.* There has been lots of excitement about semiconductor companies spending billions on new facilities to expand production, but construction delays may mean these new plants aren't productive as soon as expected. Taiwan's Nanya Technology said construction of its $10.3 billion memory chip plant will be delayed for more than six months because of shortages of materials, equipment, and construction workers, an April 11 Nikkei Asia *article* reported. Environmental and other regulatory reviews are also delaying the process. The delays will push production off by a year to at least 2025.

Chip makers are also having a tough time procuring equipment. Taiwan's UMC said its new plant is waiting on equipment delivery before it can start. "Chipmaking equipment companies from Applied Materials and KLA to ASML have told their clients that the lead time for some chip tools could be as long as 18 months," the Nikkei article stated.

Congress passed the CHIPS (Creating Helpful Incentives to Produce Semiconductors for America) Act in January 2021, but it has yet to fund the $52 billion requested to help reshore semiconductor production to the US under the new law.

Financials: Small Guys Outperforming. If Q1 earnings reports from two very different banks are any indication, smaller banks that don't have global or capital markets exposure may have enjoyed stronger Q1s than their larger counterparts that do.

Behemoth JPMorgan's Q1 *earnings* were dragged down by a decline in capital markets activity and exposure to Russia's economy. Meanwhile, First Republic Bank, which doesn't

have a capital markets arm and is focused domestically, reported a 19.9% jump in Q1 net income.

JPMorgan's loan activity was strong, with total loans up 5% y/y and net interest income increasing 8% thanks to a slight boost in net interest margin to 1.67% from 1.63% at year-end. That improvement was offset by the 28% y/y decline in investment banking revenue, 3% y/y decline in markets revenue, and a $1.5 billion provision for credit losses reflecting downside risks due to inflation, the war in Ukraine, and Russian exposure. The bank's Q1 revenue fell 5% y/y and net income fell 42% to $8.3 billion.

Conversely, First Republic *posted* a 23.0% jump in revenue to $1.4 billion. It too benefitted from strong loan activity, with its net interest income climbing 22.0% to $1.1 billion thanks to the 19.7% increase in loans outstanding. The net interest margin was flat q/q at 2.68%. The bank doesn't have a capital markets arm, but its wealth management revenue jumped 38.7% y/y to $221 million. The bank did not increase its reserves. When all was said and done, First Republic's net income increased 19.9% to $401 million.

JPMorgan's shares fell 3.2% on Wednesday, bringing the stock's ytd decline to 19.6%. Meanwhile, First Republic's shares gained 6.9% on Wednesday, but they too have fallen ytd, by 19.7%. In comparison, the S&P 500 advanced 1.1% yesterday and has fallen 6.7% ytd.

Disruptive Technologies: Technology in Aisle One. Grocery stores embraced technology during Covid lockdowns and gave customers the ability to order online and pickup in stores, keeping them as safe as possible. Covid may have waned, but the innovation hasn't stopped. A number of recent announcements show that grocers continue to go high tech:

(1) *Albertsons embraces AI.* Albertsons has begun to use Afresh's operating system to help its workers manage the fresh produce area. Part of the goal is to reduce food waste. Roughly 52% of the fruits and vegetables grown end up wasted—along with resources it took to grow them—even as people around the world go hungry and thrown-out vegetables consume landfill space. So the Afresh operating system uses a probabilistic model of future demand, shipment times, and other factors to make optimal purchasing decisions that reduce waste. It also connects the company and all of its suppliers and stakeholders across the perishable goods category.

"A 25% reduction to U.S. food waste would conserve 83B gallons of water per year, recover

90M meals per year, and eliminate 10M+ tons of greenhouse gas emissions per year," wrote Afresh's co-founder and chief technologist Volodymyr Kuleshov in a March 25, 2021 *blog* post.

The company claims that when its system was deployed in pilot programs, the grocery stores reduced food waste by up to 50% and sales increased because fewer items were out of stock.

In its April 12 *conference call* for the quarter ending March 31, Albertsons' CEO Vivek Sankaran said: "From an inventory and productivity perspective, we simplified tasks and automated production planning in our fresh departments, resulting in higher in-stock conditions and more time for customer interactions. For example, in the deli, we installed auto slicers and stackers and implemented production planning tools that increase product availability while reducing shrink and improved customer service. These changes contributed to the better-than-expected results in Fresh."

(2) *Just Walk Out technology brought in.* Just Walk Out technology, developed by Amazon and used in its Amazon Fresh stores, is spreading to other retailers, including grocers. The technology uses ceiling-mounted cameras and artificial intelligence to track shoppers' selections and charge them automatically when they exit the store. If the technology takes off, cashiers may go the way of the dinosaur.

Amazon is rolling out the Just Walk Out technology to some of its Whole Food stores. Lidl introduced Lidl Go in its London stores. Tesco has GetGo in its London location. And Aldi followed with a store in Greenwich London earlier this year, according to a March 31 *report* by JLL.

(3) *Getting drugs on the fly.* Walgreens Boots Alliance and Alphabet's Wing are offering drone delivery in Christianburg, Virginia and in the Dallas-Fort Worth metro area. Consumers can choose from 100 products for drone delivery, including over-the-counter health and wellness items. Wing says the drone can travel six miles in six minutes at a rate of 65 miles per hour with a package that weighs 3.3 pounds.

Wing is also delivering items such as ice cream from Blue Bell Creameries, first-aid kits from Texas Health, and pet prescriptions from easyvetclinic.com. In Virginia, customers can receive coffee, cupcakes, and library books in addition to items from Walgreens. Wing has been most active in Australia, where it makes roughly 1,000 deliveries a day.

Calendars

US: Thurs: Retail Sales Total, Core, and Control Group 0.6%/1.0%/0.2%; Consumer Sentiment Index Total, Current Conditions, and Expectations 59.0/68.0/54.2; Initial & Continuous Jobless Claims 171k/1.50m; Business Inventories 1.3%; Import & Export Prices 2.3%/2.2%; Natural Gas Storage; Mester. **Fri:** Headline & Manufacturing Industrial Production 0.4%/0.6%; Capacity Utilization 77.8%; Empire State Manufacturing Index 0.50; TIC Net Long-Term Transactions. (Bloomberg estimates)

Global: Thurs: ECB Interest Rate Decision & Deposit Facility Rate 0.00%/-0.50%; UK BOE Credit Conditions; China FDI. **Fri:** France CPI 4.5% y/y; Italy CPI 1.2%m/m/6.7%y/y. (Bloomberg estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) slipped a bit this week, though remained above 1.00, as bullish sentiment took a step back. The BBR ticked down to 1.12 this week after climbing the prior three weeks from 0.84 (which was the lowest since March 2020) to 1.26 last week. Bullish sentiment sank to 35.8% this week after climbing four of the prior five weeks by 9.2ppts (to 39.1% from 29.9%). Meanwhile, bearish sentiment climbed to 32.1% this week after falling the prior three weeks from 36.5% (which was the most bears since March 2020) to 31.0%. The correction count increased for the second week, also to 32.1%, after falling six of the prior seven weeks to 28.2% from 40.0%—which just missed equaling March 2020's high count of 40.9%. The AAII Ratio fell to 37.4% last week after climbing the prior two weeks from 31.1% to 53.7%, as bearish sentiment climbed from 27.5% to 41.4% last week and bullish sentiment dropped for the second week from 32.8% to 24.7% over the period.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin ticked back up last week to match its record high of 13.4% from early March. Since the end of April 2020, it has exceeded its prior record high of 12.4% in September 2018. It's now up 3.1ppts from 10.3% during April 2020, which was the lowest level since August 2013. Forward revenues and earnings were both back at record highs after ticking down briefly in early February. 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 fell 0.4ppt w/w to 7.9%. That's down from a record high of 9.6% growth at the end of May 2021, but compares to its recent 12-month low of 7.1% from early December. 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 w/w to 9.8%. 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. So far this year, analysts' revisions to their forecasts for 2022 revenues have outpaced their revisions for 2022 earnings, so the imputed 2022 profit margin estimate that we calculate from those forecasts has ticked lower. They expect revenues to rise 9.8% (steady w/w) in 2022 and 5.4% in 2023 (up 0.2ppt w/w) compared to the 16.4% gain reported in 2021. They expect earnings gains of 10.1% in 2022 (up 0.2ppt w/w) and 9.9% in 2023 (up 0.1ppt w/w) compared to an earnings gain of 51.5% in 2021. Analysts expect the profit margin to remain steady in 2022 at 13.1% (unchanged w/w) compared to 13.1% in 2021 and to improve 0.6ppt y/y to 13.7% in 2023 (unchanged w/w). The S&P 500's weekly reading of its forward P/E fell 0.7pt w/w to 19.7 from a seven-week high of 20.0, but remains above its 23-month low of 18.6 five weeks ago. 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 fell 0.08pt w/w to 2.58 from a seven-week high of 2.66, but is up from its 15-month low of 2.48 at the end of February. That compares to 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 rise for ten of the 11 S&P 500 sectors, forward earnings rise for all 11 sectors, and the forward profit margin rise for nine 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 of 10.5% is at its highest reading since February 2008. Financials 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. Four sectors are expected to see margins decline or remain flat y/y in 2022: Communication Services, Consumer Staples, Financials, and Real Estate. Here's how the S&P 500 and its sectors rank based on their

current forward profit margin forecasts along with their record highs: Information Technology (25.3%, down from its 25.4% record high five weeks earlier), Financials (18.6, down from its 19.8 record high in August 2021), Real Estate (16.4, down from its 19.2 record high in 2016), Communication Services (16.4, down from its 17.0 record high in October), Utilities (14.1, down from its 14.8 record high in April 2021), Materials (13.3, down from its 13.4 record high in December), S&P 500 (13.4, matches its record high from early March), Health Care (11.3, down from its 11.5 record high in early March), Industrials (10.2, down from its 10.5 record high in December 2019), Energy (10.5 [14-year high], down from a record-high 11.2 in 2007), Consumer Staples (7.5, down from its 7.7 record high in June), and Consumer Discretionary (8.1, down from its 8.3 record high in 2018).

US Economic Indicators

Producer Price Index (*link*): March saw the producer price index for final demand shoot up by a record-high 1.4%, following an upwardly revised 0.9% jump in February—averaging monthly gains of 1.2% during Q1. Core prices—which excludes food, energy, and trade services—advanced 0.9% last month, averaging monthly gains of 0.6% the first three months of 2022. The yearly rate for the headline measure accelerated a record 11.2% y/y, while the core rate was back at its record high of 7.0%; the former is up from 4.1% a year ago, the latter from 3.1%. The PPI for personal consumption climbed 1.3% in March, and averaged monthly gains of 1.1% the first three months of 2022—pushing the yearly rate to a record-high 10.1%. That suggests that the PCED rate could keep climbing; it was at 6.4% y/y in February—the highest since the early 1980s. During March, prices for final demand for goods matched February's 2.3% gain, which was the biggest monthly gain on record—pushing the yearly rate to a new record high of 15.7%. Over half of the broad-based increase in final demand during March was led by a 5.7% surge in final demand for energy. Meanwhile, final demand for services advanced 0.9% in March, triple February's 0.3% increase and averaging monthly gains of 0.7% during Q1; March's result boosted the yearly rate to a record-high 8.7%. Over 40% of March's 0.9% move up was traced to a 1.2% jump in margins for final demand trade services. Looking at pipeline prices, pressures remain very high, though have eased from recent highs. The yearly rate for intermediate goods prices slowed again in March, easing to 21.8% y/y, down from November's 26.5% y/y—which was its highest rate since the mid-1970s. The yearly rate for crude goods prices accelerated for the second month to 40.9%; this, after slowing steadily to 35.6% in January from 59.0% last April (within a tick of its 59.1% record high in April 1973).

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