MORNING BRIEFING
May 12, 2022

Tech Wreck, China Syndrome & Crypto Crash

Check out the accompanying chart collection.

Executive Summary: Investors aren't cutting tech stocks any slack these days. Jackie looks at how the mighty have fallen, with focus on two tech highfliers whose Q1 earnings didn't make the grade. … The fallout from China's Covid lockdowns is inflicting damage on sector after sector of the Chinese economy, with no end in sight. The government is stepping in with support programs for businesses and the unemployed. … Also: The innovation once hailed as an inflation hedge has proved to be anything but. Cryptocurrencies have shrunk in recent months to a shadow of their former value. The stocks of companies working in the crypto industry have been clobbered as well. TerraUSD breaks the buck, and investors flee the not-so-stablecoin.

Technology: The Downward March. April inflation data came in a bit hotter than expected on Tuesday, and the bond market accepted it with more aplomb than the stock market. April CPI rose 8.3% y/y, down only slightly from March's 8.5% reading (*Fig. 1*). Despite the latest sign that high inflation is persisting, the 10-year Treasury yield remained below 3.00% for most of the day, while the S&P 500 gave up 1.6% and the Nasdaq lost 3.2%.

Technology stocks continue to be among the worst performers this year. Here's the performance derby for the S&P 500 and its 11 sectors ytd through Tuesday's close: Energy (38.1%), Consumer Staples (-1.3), Utilities (-1.3), Health Care (-10.1), Materials (-10.3), Industrials (-12.5), Financials (-14.1), S&P 500 (-16.1), Real Estate (-19.5), Information Technology (-21.4), Communication Services (-26.4), and Consumer Discretionary (-27.2) (*Fig. 2*).

This week, we received March-quarter earnings reports from two former tech highfliers: Palantir Technologies and Roblox Corporation. The companies are in very different areas of technology and have very different end users. But both companies posted losses for the quarter that were ever so slight disappointments relative to analysts' earnings estimates.

Both companies' shares have been taken to the woodshed in recent months. Of course, there have been lots of similar casualties in the current tech wreck. Palantir's stock price has fallen to $7.29 as of Tuesday's close, down from its high of $35.70 on February 2, 2021. The shares were trading north of $24.00 as recently as November. Roblox's shares closed at $23.19 on Tuesday's close, having tumbled from November's high of $134.72.

Here's a look at what these two companies' managements told investors during their earnings conference calls:

(1) *Software to survive the world's uncertainties.* Palantir—a data analytics company with customers in government and private industry—grew quickly during Q1, just not as quickly as investors were hoping. The company's revenue of $446.4 million jumped 30.8% y/y and beat analysts' consensus estimate of $443 million. But adjusted earnings per share came in at two cents, compared to the analysts' consensus of four cents.

Revenue from private clients jumped 54% in Q1, but government revenue grew only 16% to $242 million, below expectations of $251 million. The company's Q2 revenue guidance also missed the mark, up only 25% to $470 million, $14 million less than analysts expected. Given what's happening in the world, Palantir sees government revenue accelerating in Q2 and H2. And the company continues to target 30% revenue growth through 2025.

Palantir's software will help the government and companies deal with the uncertainties in today's world, CEO Alex Karp said in the earnings *conference call*. It can help companies adjust to a world with inflation, food shortages, and supply-chain disruptions. He also noted that "a nuclear event is so much higher than it's being presented in the public world, that it's almost surreal to watch the coverage."

Palantir offers Foundry, a platform for data-driven decision making, on top of which it believes companies will build their own applications. Airbus, for example, built its supply-chain network tower on top of Foundry's application development infrastructure. The software mitigates supply-chain issues, speeds up production, and reduces inventory. "What AWS [Amazon Web Services] was in the last decade, Foundry will be in the next," said COO Shyam Sankar.

Palantir has come under a cloud for targeting the business of companies that came public via SPACs and investing in them, too. It has no plans to add any additional customers under this program. Palantir also has very large stock-based compensation expense that drags down earnings. Conversely, the company is conservatively funded with $2.3 billion of cash and no debt on its balance sheet.

(2) *Investors want earnings.* Roblox became an investor darling as kids trapped at home during Covid lockdowns spent far too much time on the platform playing video games and meeting up with friends. But now we've all been sprung, and kids are spending more time at school and less time on their computers. This newfound freedom hurt Roblox's results.

The company's Q1 bookings decreased 3% y/y to $631.2 million, below analysts' consensus forecast of $655.7 million. Roblox reported a net loss per share of 27 cents in Q1, an improvement from its 46 cents-per-share loss in Q1-2021 but only because there was a sharp increase in diluted shares outstanding.

After initially selling off on the news, Roblox shares bounced back after a May 11 *Barron's* *article* quoted Lightshed Partners' Richard Greenfield suggesting that Disney bid for Roblox. Such a deal would be a strategic move for Disney, helping the company enter the gaming business and the metaverse.

Roblox CEO David Baszucki noted in the company's earnings *conference call* that the March quarter would be the company's most difficult due to tough comparisons to last year. Comparisons will be easier going forward. Baszucki also spent time explaining how Roblox plans to introduce an "immersive advertising system." The company envisions a parallel economy that supports brands by bringing traffic to their experiences. There might be in-game billboards that could bring traffic to brands' own experiences, where fans could hang out and acquire virtual or physical items.

China: Hits Keep Coming. The bad news for China's economy hasn't let up. Real estate and auto sales have dropped sharply, as have manufacturing and services. Much of the decline is being driven by the Covid-induced shutdowns in Shanghai and elsewhere. How quickly the shutdowns will end and allow economic growth to accelerate is unclear. Here's a quick rundown of some recent economic data points.

(1) *Real estate slump continues.* New home sales in 23 major Chinese cities fell by 33% y/y during the May Day holiday, a May 9 Bloomberg *article* reported. Likewise, the China's top 100 developers reported drops in home sales of 58.6% y/y and 16.2% m/m in April.

(2) *Car sales drop too.* April also saw Chinese car sales drop 36% y/y and auto production drop 41% y/y with many factories closed due to Covid or lacking necessary parts. Tesla sold 1,512 cars made in its Shanghai plant, down 94% y/y and compared with 65,000 cars in March, a May 10 *WSJ* *article* reported.

Tesla isn't alone. Toyota Motor is suspending production lines at eight plants across Japan for six days starting May 16 due to parts shortages because of the Shanghai lockdown. Nissan's sales in China fell 46% y/y, and Honda Motor's China sales dropped 36% y/y. Sales from GM's China joint venture dropped 57% y/y.

(3) *A depressing PMI picture.* Adding to the bleakness, China's April manufacturing PMI sank to 47.4 in April, down from 49.5 the prior month, after being range bound from 50.1 to 50.3 the prior four months. Almost all of its components came in below 50.0, including: output (44.4), new orders (42.6), export orders (41.6), imports (42.9), and employment (47.2) (*Fig. 3* and *Fig. 4*). The only item expanding was purchase price (64.2) (*Fig. 5*). China's non-manufacturing purchasing managers index also fell in April to 36.2 (*Fig. 6*).

(4) *Government jumping in.* Premier Li Keqiang warned that China's employment situation was "complicated and grave," which increased fears about the fallout from the Covid lockdowns. "[H]e instructed all levels of government to prioritize measures to boost jobs and maintain stability," May 9 CNN *article* reported. "These measures include helping small businesses survive, supporting the internet economy, providing incentives to encourage people to start their own business, and giving unemployment benefits to laid-off workers."

The MSCI China index fell 8.8% in May through Tuesday's close and is down 24.0% ytd compared to the S&P 500's 3.2% loss so far this month and 16.1% decline ytd through Tuesday's close (*Fig. 7*).

Disruptive Technologies: Crypto Gets Crushed. Over the last few months, cryptocurrencies have failed to live up to the hype that they would serve as a hedge against inflation. Despite the surge in inflation in recent months, the price of bitcoin has fallen 54.0% from its November high of $67,802 to $31,209 at day-end Tuesday (*Fig. 8*). That's far worse than the 14.6% drop in the S&P 500 and the 1.5% gain in the price of gold over the same period.

Many other cryptocurrencies have lost more than half of their value as well. Here are how some of the largest cryptocurrencies have performed from their highest price last year through Tuesday's close: Dodgecoin (-85.1%), Aave (-84.4), Solana (-74.6), XRP (-71.2), Avalanche (-70.3), Bitcoin (-54.4), Ethereum (-51.8), and BNB (-51.5).

The damage extends far beyond the cryptocurrencies themselves. A whole world of exchanges, investment vehicles, and financial firms have grown up around cryptos, and they too have fallen sharply in value.

The shares of Coinbase Global fell 19.3% on Wednesday to $53.72 after the crypto exchange reported Q1 earnings. In November, the shares hit a peak of $357.39. Crypto miner Riot Blockchain's shares have fallen to $7.75 on Tuesday, down from $44.19 in November. The shares of Silvergate Capital, which provides banking services to the digital currency industry, have fallen to $85.86 on Tuesday, down from $222.13 in November. And ProShares Bitcoin Strategy ETF, the first bitcoin-linked ETF listed in the US, has fallen from $43.28 shortly after it listed in October to $19.44 on Tuesday's close.

This week, earnings out of Coinbase Global and TerraUSD falling below $1 has disappointed the market. Here's a look at what happened to both players:

(1) *Less trading, less profit.* There reportedly are more than 300 crypto exchanges, but Coinbase is among the largest, and it didn't have good news for investors on Tuesday. Q1 net revenue fell 27.1% y/y as trading volume fell 7.8%, the company's quarterly earnings *letter* stated. Monthly transacting users (MTUs) rose 50.8% y/y but fell 19.3% q/q. Coinbase's employees more than doubled y/y, as did operating expenses.

With lower revenue and higher expenses, Coinbase reported a loss of $430 million, down from a profit of $771 million in Q1-2021. Even adjusted EBITDA cratered to $20 million, down from $1.1 billion in Q1-2021. Given the current market environment, Coinbase expects Q2 to have lower transaction volumes and lower MTU than Q1, CFO Alesia Hass said in the company's earnings *conference call* on Tuesday. As we mentioned above, the shares fell sharply on the news.

(2) *Breaking the buck*. Terraform Labs, headquartered in Seoul, was founded in 2018 by Daniel Shin and Do Kwon. It created crypto coins TerraUSD and Luna. TerraUSD, an algorithmic stablecoin that tracks the value of the dollar, had a market cap of more than $18 billion just last weekend. By Wednesday, its market cap was only $9.1 billion.

Most stablecoins own $1 in assets for every $1 token they issue. Terra doesn't. If Terra falls in value, an algorithm lets investors "burn," or remove the coin from circulation, in exchange for $1 of Luna. The transaction would decrease the supply of TerraUSD and theoretically cause its price to increase and remain at $1. The algorithm works in reverse, too. If TerraUSD rises higher than $1, investors can "burn" Luna and receive TerraUSD, increasing the supply of the cryptocurrency, an excellent May 9 *WSJ* *article* explained.

The Luna Foundation Guard, created by Kwon to support TerraUSD and Luna, says it will lend $750 million in bitcoin to trading firms to defend the TerraUSD price peg. The foundation was also expected to buy $10 billion of bitcoin earlier this year to provide a backstop to TerraUSD. That led to fears that the foundation would sell its bitcoin, putting additional downward pressure on the price of bitcoin, a May 9 CNBC *article* reported.

The value of TerraUSD fell to a low of 26 cents on Wednesday before rebounding to 73 cents later that day. Luna, which traded as high as $116.06 in April, has fallen to $10.61 on Tuesday and to $1.11 on Wednesday, according to Coinbase.

Again, the ripple effects go beyond the TerraUSD and Luna cryptocurrencies. Terraform Labs also created Anchor, a saving, lending, and borrowing platform built on the Terra blockchain. Investors who deposit TerraUSD on the Anchor platform were able to earn 19.5%. The juicy yield presumably prompted some investors to buy TerraUSD just so they could deposit it with Anchor.

TerraUSD's breaking the buck has spooked Anchor depositors, who have been withdrawing funds since Friday in what's being compared to a run on a bank. Anchor's $14 billion of deposits have shriveled to $5.5 billion on Tuesday and $3.1 on Wednesday.

It's unclear how Anchor affords the 19.5% it pays depositors. It has $5.5 billion of deposits but only $765.1 million of loans. Anchor borrowers pay about 10% on their loans, according to an April 19 Motley Fool *article*. They also have to contribute collateral, on which Anchor earns a yield. The Motley Fool article contends that to make up the difference between what its loans generate and the 19.5% it pays out on its deposits, Anchor has "been eating into its reserves." According to Motley Fool, Luna Foundation had replenished Anchor's reserves with $450 million in February. Anchor's yield reserve appears to have fallen to $178.8 million, according to its *website*.

(3) *Yellen is watching.* Regardless of how the TerraUSD/Luna/Anchor mess resolves, it has caught the attention of Treasury Secretary Janet Yellen. She told the US Senate Banking Committee on Tuesday that the situation indicated multiple risks: risks to financial stability, risks to the payment system and its integrity, and risks associated with the increased concentration of market players if stablecoins are issued by firms that already have lots of market power. Legislation to address crypto regulation would be "appropriate" this year, she said according to a May 10 CoinDesk *article*.

Calendars

US: Thurs: Headline & Core PPI 0.5%m/m/10.7%y/y & 0.6%m/m/8.9%y/y; Initial & Continuous Jobless Claims 195k/1.38m; Natural Gas Storage; IEA Monthly Report; OPEC Monthly Report. **Fri:** Consumer Sentiment Headline, Current Situation & Expectations

64.0/70.5/63.0; Import & Export Prices 0.6%/0.7%; Baker-Hughes Rig Count; Mester; Kashkari. (Bloomberg estimates)

Global: Thurs: UK GDP 1.0%q/q/9.0%y/y; NIESR Monthly GDP Tracker; UK Headline & Manufacturing Industrial Production 0.1%m/m/0.5%y/y & -0.5%m/m/2.3%y/y; UK Trade Balance -£18.5b; China New Loans & M2. **Fri:** Eurozone Industrial Production -2.0%m/m/-1.0%y/y; Schnabel. (Bloomberg estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) moved further below 1.00 this week as bullish sentiment sank to its lowest percentage since early 2016. The BBR dropped to 0.68 this week—the lowest since mid-February 2016—after bouncing around 1.00 since late February. Bullish sentiment declined for the fourth time in five weeks by 11.5ppts (to 27.6% from 39.1%), while bearish sentiment rose 9.8ppts (40.8 from 31.0) over the period to its highest percentage since March 2020. The correction count climbed to 31.6% this week after falling from 34.6% to 29.8% the prior two weeks; it was as high as 40.0% in early February. The AAII Ratio rose to 33.7% last week after falling three of the prior four weeks from 53.7% to 21.7%—which was the lowest since March 2009—as bullish sentiment climbed from 16.4% to 26.9% last week and bearish sentiment fell from 59.4% to 52.9%.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin ticked down to 13.3% last week from its record high of 13.4% a week earlier. 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 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 0.2ppt 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 ticked down 0.1ppt w/w to 9.7%. 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 down 0.2ppt to 13.0%. They expect revenues to rise 10.6% (up 0.5ppt w/w) in 2022 and 5.1% in 2023 (down 0.2ppt w/w) compared to the 16.4% gain reported in 2021. They expect earnings gains of 10.0% in 2022 (down 0.1ppt w/w) and 9.9% in 2023 (unchanged w/w) compared to an earnings gain of 51.0% in 2021. Analysts expect the profit margin to drop in 2022 to 13.0% (down 0.1ppt w/w) compared to 13.1% in 2021 and to improve 0.6ppt y/y to 13.6% in 2023 (down 0.1ppt w/w). Just before the selloff that began last Friday, the S&P 500's weekly reading of its forward P/E rose 0.4pt w/w to 18.3 from a 25-month low of 17.9. 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 rose 0.05pt w/w to 2.44 from a 30-month low of 2.39. 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 all 11 S&P 500 sectors, forward earnings rise for all but Consumer Discretionary and Health Care, and the forward profit margin move higher 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 of 11.1% improved to its highest reading since September 2007. Financials and Utilities have forward earnings at 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 now expected to see margins decline or remain flat y/y in 2022: Communication Services, Consumer Staples, Financials, Health Care, 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%, down from its 25.4% record high in late February), Financials (18.9, down from its 19.8 record high in August 2021), Real Estate (16.6, down from its 19.2 record high in 2016), Communication Services (16.0, down from its 17.0 record high in October), Utilities (14.0, down from its 14.8 record high in April 2021), Materials (13.5, a new record high this week), S&P 500 (13.3, down from its 13.4 record high a week earlier), Health Care (11.1, down from its 11.5 record high in early March), Industrials (10.3, down from its 10.5 record high in December 2019), Energy (11.1

[15-year high], down from a record-high 11.2 in 2007), Consumer Discretionary (7.7, down from its 8.3 record high in 2018), and Consumer Staples (7.4, down from its 7.7 record high in June).

US Economic Indicators

CPI (*link*): April's CPI increased 0.3%, just one-quarter of March's 1.2%—which was its biggest monthly gain since September 2005. Core prices increased 0.6% in April, double the 0.3% of last June; they've averaged monthly gains of 0.5% over the past seven months. April's yearly inflation rate eased a bit, to 8.3%, after accelerating to 8.5% in March—which was the highest since December 1981. (April's headline CPI rate is 2.8ppts above the 5.5% gain in average hourly earnings for all employees that month.) Core prices also eased a bit in April versus a year ago, ticking down to 6.2% from 6.5% in March—which was the highest since August 1982. Here's a look at yearly rates across the spectrum: food (9.4% y/y) costs are accelerating at the fastest pace since the early 1980s, with the rate for food away from home (7.2) the highest since November 1981 and the rate for food at home (10.8) the highest since November 1980. The yearly rate for energy (30.3) costs continued to bounce around 30.0%, with April's rate below its recent peak of 33.3% in November—which was the fastest pace since September 2005. Fuel oil (80.5% from 70.1% y/y) continued to accelerate, posting its highest rate since February 2000, while the rate for gasoline (to 43.6 from 48.0) continued to slow from its recent peak of 58.1% in November. The increase in electricity (11.0 from 11.1) was little changed from March's rate, which was the highest since September 2006. Meanwhile, the yearly gain in natural gas prices edged up to 22.7% in April after slowing steadily from 28.1% in October (the highest since summer 2008) to 21.6% in March. The consumer durable goods (14.0 from 17.4) inflation rate slowed for the second month from February's 18.7%—which was the highest rate since the record high of 20.2% in the early 1940s. The consumer nondurable goods (12.8 from 13.1) rate was little changed around March's rate—which was the highest percentage since mid-1980. The rate for new vehicles (13.2 from 12.6) accelerated at a near-record pace, while the rate for used cars & trucks slowed to 22.7% y/y in April after accelerating from 24.4% in September to 41.2% in February—which was within striking distance of June 2021's record rate of 45.2%. Apparel prices (5.4 from 6.8) slowed in April after increasing at its fastest rate since the end of 1980 in March, while the rate for furniture & bedding (15.0 from 15.8) slowed for the second month from February's 17.1% record high. The yearly rate for medical care commodities (2.1 from 2.7) remained positive for the sixth month, though eased from March's rate, which was the highest since May 2018; before November's 0.2%

uptick, the yearly rate had been in negative territory for 13 successive months. Within services, owners' equivalent and tenant-occupied rents both accelerated 4.8% y/y in April—up from recent lows of 2.0% and 1.8%, respectively—with the former the highest since February 1991 and the latter since March 1987; over the three months through April, they accelerated at annual rates of 5.4% and 6.3%, respectively. Meanwhile, the rate for lodging away from home (19.7) eased from the 25.1% record high posted in both February and March. Meanwhile, the yearly rate for hospitals' (3.6 from 3.3) services has been moving in a relative flat trend, while the physicians' (1.2 from 0.7) services rate ticked up in April but was down sharply from last March's 5.3% peak. The yearly rate for airfares (33.3 from 23.6) shot up in April to its highest rate since the end of 1980, as airfares soared 152% (saar) during the three months through April.

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