MORNING BRIEFING
May 26, 2022

Energy, Retailing & Hydrogen

The next *Morning Briefing* will be on May 31.

Check out the accompanying chart collection.

Executive Summary: Spending on stuff was so yesterday. Long-cooped-up consumers now want to spend on experiences and have fun! Not even stratospheric gasoline pump prices will keep them home this holiday weekend. Today, Jackie examines the factors driving energy prices skyward. … Also, some retailers' Q1 earnings reports revealed a have/have-not dichotomy in the consumer discretionary space. Specifically, high-end Nordstrom made out far better last quarter than did retailers to the masses. … And: An update on the expanding use of hydrogen to fuel trucks, trains, and even factories.

Energy: Americans Hit the Road. The national average price for a gallon of gasoline hit a record high of $4.69 a gallon on Monday, up 51% y/y (*Fig. 1*). Higher prices at the pump aren't expected to keep drivers from hitting the road over Memorial Day weekend, however. AAA expects 34.9 million drivers will be on US roads this weekend, a 4.6% jump over the number on Memorial Day weekend 2021 but still 7.3% below the (pre-pandemic) 2019 figure. Another 3.0 million people are expected to travel by plane this weekend, up 25% over last year's number and down only 6.3% from the 2019 level.

We've been expecting a surge in travel, as vaccines and medicines have kept Covid hospitalizations extremely low. As consumers' Covid caution has dissipated, so has their desire to nest cozily at home. Spending on stuff is out, while spending on experiences and services is in. The shift was clear last week when Target said spending on luggage was up more than 50% but spending on TVs and home goods fell.

It's quite a reversal from the surge in spending on durable and non-durable goods that occurred over the past two years (*Fig. 2* and *Fig. 3*). The surge is even more dramatic excluding motor vehicles and parts spending from durable goods spending (*Fig. 4*). Conversely, spending on services has remained below its pre-pandemic levels as of the latest available data, for March (*Fig. 5*).

Now it looks like consumers are ready to make up for lost time this summer even if it means spending more at the pump and in the air. Unfortunately, the Ukraine war and slim supplies at home are conspiring to make our road trips a lot more expensive. Spending on gas in March represented 2.6% of consumer budgets, which is up from the pandemic low of 0.7% in April 2020 but well off the July 2008 high of 3.8% (*Fig. 6*).

Here's a look at what's driving oil prices:

(1) *Dividends trump drilling.* US crude oil production is up sharply from the low of 4.1mbd during 2008; but at 11.9 mbd, production is still well off its October 2019 high of 13.1mbd (*Fig. 7*). Meanwhile, domestic demand has rebounded, and exports of crude oil and petroleum products has exceeded imports by 1.2 mbd using a four-week moving average (*Fig. 8*).

Strong demand and light supply have led to tight inventory levels. The US has 396.3 million barrels of crude oil in inventory, down from 459.0 million at this time last year, 496.9 million in 2020, and 453.0 million barrels in 2019 (*Fig. 9*). US stock of finished motor gasoline is lower today than it has been over the past three years at this time of year. There are 18.8 million barrels of US stock of finished motor gasoline, compared to 20.9 million barrels last year, 24.9 million barrels in 2020, and 24.3 million barrels in 2019 (*Fig. 10*).

The Biden administration has made some moves to ease the market's tightness. US Energy Secretary Jennifer Granholm said on Tuesday that President Biden hasn't ruled out export restrictions to help ease US energy prices. And the administration has announced plans to release 1 mbd from the Strategic Petroleum Reserve for six months. However, the Biden administration has also made some moves that will reduce US production in the future. It suspended oil leases in the Arctic National Wildlife Refuge in Alaska; it canceled plans to auction drilling rights in two areas in the Gulf of Mexico and one off the coast of Alaska; and it restored the National Environmental Policy Act, which imposes stricter environmental standards for new pipelines and other construction projects.

Meanwhile, US oil and gas companies have opted to return excess cash to shareholders via dividends and buybacks instead of using it to sharply increase their drilling. The US oil and gas rig count is 728, up from its Covid low of 244 in August 2020 but below the 2018 high of 1,083 and even further below the 2011 high of 2,026 (*Fig. 11*). The industry has been hindered by higher costs, tight labor markets, and shareholder demands that companies return capital, go green, and stop spending on "dirty" fuels. Executive compensation, once based on production targets, now focuses on profitability, cost control, and returning cash to shareholders, a May 23 *WSJ* *article* reported.

(2) *Saudis won't help.* Saudi Aramco has no intention of increasing oil production beyond plans that existed prior to the Ukraine war, said Aramco CEO Amin Nasser as quoted in a May 23 Reuters *article*. The company plans to boost oil production capacity from 12mbd today to 13mbd by 2027. The company is slowly raising output according to an agreement struck by OPEC and Russia. The country is producing 10.5mbd and will likely raise production to 11.0mbd later this year.

Perhaps the Saudis are reticent to help because they can see the 62 million barrels of Russian crude oil in ships at sea looking for a home. The US and other countries have banned imports of Russian crude, and those that haven't banned the imports are afraid to buy Russian crude for fear of being sanctioned themselves. The amount of Russian oil at sea is three times the pre-war average, according to Vortexa data in a May 24 Reuters *article*. The seaborne oil is also notable relative to the Russian seaborne oil exports, which fell to 6.7 million barrels per day, down 15% in May compared to February.

(3) *Items to watch.* If economic growth comes in hotter than expected, it could push oil prices up. Aramco's Nasser told Reuters that the world has less than 2% spare capacity. The aviation industry is still using 2.5mbd less today than it did before the Covid pandemic. If flying returns to pre-Covid levels, "you are going to have a major problem."

Likewise, if China can keep Covid cases at bay, its economy should improve and boost demand for oil. Cases in Shanghai have fallen sharply, and the city is on track to begin a phased reopening starting June 1; but Covid cases in Beijing have been ticking up in recent weeks. Conversely, the spike in energy and food prices in Europe seems on track to cause a recession in the region.

At some point, high oil prices will solve the problem of high oil prices. They might cause demand destruction either by pushing countries into recession or by encouraging consumers to conserve energy or switch to electric or hybrid vehicles. US electric vehicle (EV) sales rose 76% y/y in Q1 to 173,561 vehicles. That doubled EVs' market share to 5.2%, up from 2.5% in Q1-2021, according to Kelley Blue Book data published in a April 28 *Inside Climate News* *article*. Notably, EV sales were up at a time when overall sales of new cars and trucks were down: They fell 15.7% during Q1 to 3.3 million vehicles, hurt by chip and parts shortages.

Consumer Discretionary: The Haves Keep Buying. After last week's brutal earnings reports from Walmart and Target, the consumer discretionary space got some good news from Nordstrom: The company was able to increase its forecasts because its customers, wealthier than most, are still spending. Earnings from Dick's Sporting Goods and Abercrombie & Fitch, however, reinforced the message that retailers to the masses are facing slowing sales and rising expenses. Let's take a look:

(1) *Dressing to impress.* Nordstrom beat analysts' Q1 (ended April) sales forecast and increased its 2022 earnings and revenue guidance as shoppers returned to its stores and refreshed their wardrobes. "This quarter we saw customers shopping for long-anticipated in-person occasions such as social events, travel, and return to office," said CEO Erik Nordstrom in the company's earnings *conference call*. President Pete Nordstrom noted that men's apparel was the strongest category in the quarter, but both men's and women's apparel had double-digit y/y growth driven by suits and dresses. The retailer increased average retail prices without seeing transaction volumes drop. Nordstrom in-store sales jumped 19% y/y in Q1, while digital sales were flat.

"At this point, we have not seen inflationary cost pressures adversely impact customer spending, which we believe is due to the higher income profile and resiliency of our customer base," said CFO Anne Bramman. The number of customers shopping and the amount spent by each customer increased. The gross margin increased by 1.9ppts.

Nordstrom now expects this fiscal year's (ending January) adjusted earnings before share buybacks to be $3.20-$3.50 a share, up from previous guidance of $3.15-$3.50 a share. Revenue is expected to grow 6%-8%, up modestly from a previous estimate of 5%-7%. Nordstrom shares jumped 14.0% Wednesday and are up 4.2% ytd through Wednesday's close, trouncing the S&P 500's -16.5% return.

(2) *Dick's & A&F not as fortunate.* Dick's Sporting Goods' Q1 (April) sales fell 7.5% y/y, reflecting tough comparisons to Q1-2021, when purchases of exercise equipment and outdoor gear surged as customers sought to pass the time during the Covid outbreak. The company lowered its full fiscal year earnings guidance to $9.15-$11.70 a share, down from an earlier estimate of $11.70-13.10 a share. Despite the trimmed outlook, Dick's shares rallied 9.7% on Wednesday but remain down 32.1% ytd through Wednesday's close.

Teen retailer Abercrombie & Fitch reported a 27-cents-per-share loss in its Q1 (April), far below the two cents a share that analysts had expected the company to earn. Management has stopped providing full-year earnings guidance, but lowered its revenue guidance for this fiscal year (January) to flat to up 2%, compared to an earlier forecast of 2%-4% growth. The company cited foreign currency headwinds, lower consumer demand due to inflation, and higher freight and raw material costs, a May 24 *Barron's* *article* reported. Abercrombie shares tumbled 28.6% on Tuesday, but rallied 16.5% on Wednesday, leaving them down 36.2% ytd.

Disruptive Technologies: Hydrogen Use Expands. We took a look at how truck manufacturers were using hydrogen to fuel big rigs in the March 18, 2021 *Morning Briefing*. Hydrogen can propel these road warriors for longer distances than batteries, and refueling is much faster than recharging batteries. One major hurdle is building refueling infrastructure; but in many commercial applications, trucks run between two static points repeatedly, which lends itself to companies making the investment.

Lately, we've noticed that the use of hydrogen has expanded beyond big rigs to other large vehicles like garbage trucks, mining haulers, trains. Even a steel plant is using the powerful fuel. Here's a look at some of the recent news:

(1) *Garbage trucks clean up.* Garbage trucks around the world are going green. In Australia, Pure Hydrogen and JJ Waste & Recycling are partnering to build hydrogen garbage trucks before year-end. If they're successful, JJ Waste plans to "transition" its 2,000 trucks to the fuel, a March 22 *article* in *PV Magazine* reported. Pure Hydrogen uses natural gas to create hydrogen, so it's not considered as green as hydrogen created by using renewable energy sources, like wind or soar energy. Hyzon and Superior Pak are also making hydrogen garbage trucks in Australia.

In the UK, the city of Aberdeen is buying hydrogen garbage trucks with a Hyzon motor that have a range of 155 miles, a May 24 *article* in the *Catholic Transcript* reported. The city already runs hydrogen-powered buses. The garbage trucks are made by Dutch trash collection company Geesinknorba. Separately, Hyzon has agreed to supply 300 hydrogen trucks to the Dutch company over three years. Hyzon hydrogen systems are being or will be used in "waste collection vehicles" in Barcelona, the Netherlands, and Australia, a December 21, 2021 *article* in Electrive reported.

(2) *Hydrogen on the rails.* Canadian Pacific railroad has asked Ballard Power Systems to convert three of CP's existing diesel engines to hydrogen power, each with power output of 200kW. The company aims to increase its use of a "green" fuel without the added carbon cost of building new chassis, a January 20 Electrek *article* reported.

(3) *Hydrogen trucks digging deep.* UK mining company Anglo American is using the world's largest hydrogen-powered mine haul truck in South Africa. The truck's hydrogen fuel cells generate more power than trucks powered by diesel, and they can carry a 320-ton payload,

a May 6 *Electrek* article reported. If successful, Anglo American plans to replace its 40-truck fleet, which uses about a million liters of diesel annually, with trucks powered by hydrogen made from solar power.

(4) *Making green steel.* SSAB has been using hydrogen to power a steel plant in Sweden since last summer. The steel industry is responsible for 8% of the world's CO2 emissions, so the SSAB plant could be a major advancement. SSAB aims to switch its furnaces over to green production by 2030. This green steel costs 25% more than traditional steel to produce and requires very high-quality iron ore. Time will tell whether buyers will pay up for it or whether technological advances will bring the price down.

Calendars

US: Thurs: Real GDP & GDP Price Index -1.3%/8.0%; Core PCED 5.2%; Corporate Profits; Kansas City Fed Manufacturing Index; Initial & Continuous Jobless Claims 215k/1.31m; Pending Home Sales -2.0%; Natural Gas Storage. **Fri:** Personal Income & Consumption 0.5%/0.7%; Headline & Core PCED 0.4%m/m/4.9%y/y; Consumer Sentiment Index 59.1; Goods Trade Balance; Baker-Hughes Rig Count; Bullard. (Bloomberg estimates)

Global: Thurs: Italy Business & Consumer Confidence 109.0/100.5; Canada Headline & Core Retail Sales 1.4%/2.0%; Australia Retail Sales 0.9%; China Industrial Profits; World Economic Forum Annual Meetings. **Fri:** Spain Retail Sales -1.9%; Lane. (Bloomberg estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) was below 1.00 for the fourth successive week this week, edging up to 0.69 this week, after dropping the prior three weeks from 1.04 to 0.65—which was the lowest since mid-February 2016. The BBR has been bounding around 1.00 since late February. Bullish sentiment barely budged for the second week, edging up to 28.2% this week from 27.6% (lowest since early 2016) during the May 10 week. Bearish sentiment slipped to 40.8% this week after climbing five of the prior six weeks by 12.0ppts (to 43.0 from 31.0)—with last week's 43.0% reading the highest since October 2011. The correction count edged up to 31.0% his week after dropping three of the prior four weeks from 34.6% to 29.2%; it was as high as 40.0% in early February. The AAII Ratio climbed for the second time in three weeks last week from 21.7% (the lowest since March 2009) to 34.0% over the period. Bullish sentiment ticked up to 26.0% last week after slipping from 26.9% to 24.3% the prior week, while bearish sentiment edged up to 50.4% after falling from 59.4% to 49.0% the previous two weeks.

S&P 500 Sectors Net Earnings Revisions (*link*): The S&P 500's NERI improved m/m in May for the first time in four months, but was higher m/m for only the second time in the past 10 months. It rose to 2.5% from a 21-month low of 1.9% in April and was positive for a 21st month following 13 straight negative readings. That exceeds the prior 18-month positive streak during the cycle that ended October 2018, when NERI reached a then tax-cut-induced record high of 22.1% in March 2018. May's reading compares to a record-high 23.1% in July 2021 and an 11-year low of -37.4% in May 2020. Seven of the 11 S&P 500 sectors had positive NERI in May, up from five a month earlier, as Materials and Industrials turned positive m/m. Five sectors had NERI readings at post-pandemic lows during the month, but six had NERI improve m/m, up from five rising in April. Among the underperforming sectors, Communication Services was negative for a seventh month, Consumer Staples for a third, and both Consumer Discretionary and Health Care for a second month. Here are the May NERIs for the S&P 500 and its sectors compared with their April readings: Energy (45.3% in May [record high], up from 32.8% in April), Materials (12.0 [8-month high], -1.2), Financials (7.8, 4.6 [21-month low]), Real Estate (6.8, 2.1), Industrials (5.1 [7-month high], -0.8), Information Technology (4.2 [22-month low], 6.9), Utilities (3.9 [8-month high], 0.0), S&P 500 (2.5, 1.9 [21-month low]), Health Care (-4.7 [22-month low], -0.9), Consumer Discretionary (-7.4 [22-month low], -2.8), Consumer Staples (-8.1 [22-month low], -5.1), and Communication Services (-15.5 [23-month low], -11.9).

MSCI World & Region Net Earnings Revisions (*link*): Analysts' recent earnings revisions through May suggest weaker and increasingly negative optimism about profits throughout the world. The US MSCI's NERI was positive in May for a 22nd straight month after 14 negative readings, and edged up to 0.3% from a 21-month low of less than 0.1% in April. That compares to post-pandemic high of 21.1% in July and an 11-year low of -36.9% in May 2020. The AC World ex-US MSCI's NERI was negative for a third month following 17 straight positive readings, falling to a 22-month low of -3.8% from -2.9% in April. NERI was negative in May for EM Asia, EM Eastern Europe, and the Emerging Markets as all but EM Latin America weakened m/m. Here are May's scores among the regional MSCIs: EM Latin America (5.6% in May [9-month high], up from 3.4% in April), EMU (2.4, 0.7), Europe (1.3, -0.3 [18-month low]), Europe ex-UK (1.2, -0.9 [18-month low]), EAFE (0.4, -0.2 [18-month low]), US (0.3, less than 0.1 [21-month low], 3.6), EM Eastern Europe (-1.6 [21-month low], -0.2), AC World (-2.7 [22-month low], -2.1), AC World ex-US (-3.8 [22-month low], -2.9), Emerging Markets (-7.0 [22-month low], -5.0), and EM Asia (-8.2 [23-month low], -6.1).

US Economic Indicators

Durable Goods Orders & Shipments (*link*): Core capital goods orders and shipments both reached new record highs again in April, as companies have been attempting to boost productivity to compete with high inflation and a tight labor market. Nondefense capital goods shipments excluding aircraft (used in calculating GDP) has climbed every month but one since its April 2020 bottom, rising 0.8% in April and 31.1% over the period. Meanwhile, core capital goods orders (a proxy for future business investment) has advanced all but two months since April 2020, up 0.3% and 31.6% over the comparable periods. Overall durable goods orders expanded for the sixth time in seven months—by 0.4%m/m and 7.5% over the seven months through April—on widespread strength over the period: Motor vehicles & parts (14.5%), primary metals (7.6), computers & related products (6.9), electrical equipment & appliances (5.5), machinery (4.5), communications equipment (3.3), and fabricated metals (3.1). Looking ahead, however, recent monthly surveys from three Federal Reserve districts—New York, Philadelphia, and Richmond—were troublesome, showing orders growth (to -0.9 from 16.3) this month at a virtual standstill.

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