MORNING BRIEFING
May 31, 2022

Valuation Meltups & Meltdowns

Check out the accompanying chart collection.

Executive Summary: Valuation is in the eye of the beholder, but the economic outlook that influences it isn't as subjective or hard to forecast, with lots of data available to help. … We think forward P/Es may be range bound this year and next and the S&P 500 may remain volatile below its January 3 high before climbing to new highs in 2023 and 2024. … Recession fears are weighing on valuations. We raised the odds of a mild recession to 40%, up from 30%, last week and again explain why. … Also: We discuss the variables suggesting a moderation of inflation ahead, led by consumer durables. … Finally: Dr. Ed reviews "Benjamin Franklin" (+ + +).

YRI Tuesday Webcast. View Dr. Ed's PRE-RECORDED webinar for Tuesday, May 31, available *here*.

Strategy I: A Good Week for a Change. On Wednesday, May 18, Target's stock price plunged 24.9% on disappointing reported earnings for Q1. Investors concluded that consumers were cutting back on spending and that corporate profits were starting to get squeezed. The S&P 500 fell to the year's closing low of 3900.79 on Thursday, May 19 (*Fig. 1*). At that level, it was down 18.7% from its record high on January 3. The next day, it briefly entered bear-market territory on an intraday basis, but it closed Friday just a hair above Thursday's close—narrowly escaping being branded a "bear market."

Since the May 19 low, the S&P 500 rose 6.6% to close at 4158.24 on Friday, May 27. Most of that rebound followed Macy's better-than-expected reported earnings, which caused its stock price to jump 19.3% on Thursday, May 26. The fun continued on Friday with a 2.5% gain for the S&P 500 after the Bureau of Economic Analysis (BEA) reported that inflation-adjusted consumer spending rose in April and inflation moderated slightly.

Investors concluded that the various earnings reports from retailers released over the past several days along with the BEA report suggested that their knee-jerk reaction to the Target news was too pessimistic, causing an unwarranted jump to conclusions about both consumer spending and profit margins.

The conventional wisdom now seems to be more nuanced. Consumers are having to spend more on gasoline and groceries, which might be forcing some of them to cut spending on discretionary consumer goods. However, some of the weakness in spending on such merchandise may also reflect the satiation of lots of pent-up demand for them. The good news is that weakening demand for discretionary consumer durables may be putting some downward pressure on their prices.

In addition, the BEA data showed that consumer spending on services continued to rise and that consumers dipped into their savings to offset weakness in their real incomes. We examine the BEA data on consumer spending and inflation below. But first, let's review how the valuation multiple has been driving the stock market since the start of the pandemic in the following section.

Strategy II: Valuation & Beauty. I've always maintained that predicting the stock market is easy. You need only to forecast two variables, i.e., earnings and the valuation multiple. Getting them right is the hard part. Getting the valuation multiple right is especially hard. In my book *Predicting the Markets: A Professional Autobiography* (2018), I observed, "Judging valuation in the stock market is akin to judging a beauty contest." That's because beauty is in the eye of the beholder. Behold the following:

(1) *Breadth.* The S&P 500 equal-weighted stock price index was down 13.7% from January 3 through its most recent low, on May 11. On Friday, it was down only 7.9%, while the S&P 500 was down 13.3% since January 3 (*Fig. 2*). To a large extent, this year's selloff has been led by the S&P 500 Growth index, specifically its MegaCap-8 components. In other words, the selloff has mostly reflected a correction of the pandemic era's valuation excesses in these eight very highly valued and capitalized stocks. Now, behold this …

(2) *S&P 500 valuation.* Just before the pandemic lockdowns, the forward P/E of the S&P 500 rose to the bull market's high of 19.0 on February 19, 2020 (*Fig. 3*). It plunged to a low of 12.9 on March 23, 2020. It then soared to peak at 23.2 on September 2, 2000. This valuation multiple lost some ground through the end of 2021. But it was still historically high at 21.5 on January 3 of this year, when the market rose to its record high.

Increasingly hawkish pronouncements from Fed officials since the start of this year led to a jump in the 10-year US Treasury bond yield, which peaked at 3.12% on May 6, and also stoked fears that tighter monetary policy would cause a recession (*Fig. 4*). So the forward P/E plunged to 16.4 on May 19. That P/E meltdown retraced more than half of the P/E meltup during the pandemic.

Joe and I recently expected that 16.0 might be the level that halts the P/E meltdown for now. Apparently, 16.4 on May 19 might have done the trick, as the forward P/E rebounded to 17.5 at the market's close on Friday. Last week, in Wednesday's *Morning Briefing*, Joe and I concluded that the increasing odds of a recession—along with more Fed tightening ahead (including two 50bps rate hikes, in June and July, and the start of QT2 in June)—should keep the S&P 500's forward P/E range bound between 15.0 and 17.0 (*Fig. 5*).

(Predicting the market's valuation multiple is starting to remind me of my three dogs trying to catch a rabbit in our backyard with no success. I hope that my wife and I will be as successful at dodging bears as our backyard rabbit is at dodging our dogs when we visit Yellowstone National Park this week!)

(3) *Valuation of S&P 500 MegaCap-8, Growth, and Value.* The following are the forward P/Es on January 3, when S&P 500 hit its record high; on May 19, its recent low; and the change over that timespan for the S&P 500 Growth MegaCap-8 (33.8, 22.9, -32%), S&P 500 Growth (28.5, 19.7, -31%), S&P 500 (21.5, 16.4, -24%), and S&P 500 Value (17.2, 14.5, -16%) (*Fig. 6*). A week ago, the MegaCap-8 forward P/E was almost back down to its pandemic lockdown low of 21.6 during the week of March 20, 2020.

The MegaCap-8 stocks currently account for 21.9% of the market cap of the S&P 500 (and a whopping 46.1% of the S&P 500 Growth composite) (*Fig. 7*). During 2018 and 2019, these eight stocks boosted the forward P/E of the S&P 500 by about 1 point (*Fig. 8*). Following the end of the lockdowns, they added around 2.5 points to the S&P 500's multiple from mid-2020 through the end of 2021.

(4) *Revenues, earnings, and margins.* Meanwhile, S&P 500 industry analysts remain oblivious to all the recession chatter. They are sticking to their story, and they aren't showing any signs of changing it: Their companies' revenues are rising to record highs, boosted by rising prices. Furthermore, their companies' earnings are doing the same, implying that companies collectively are able to pass along their rapidly rising costs into their rapidly rising selling prices. As a result, their profit margins are remaining steady at a record high, according to the analysts.

We can see all that in the S&P 500's per-share weekly series for forward revenues, forward earnings, and the forward profit margin through the May 19 week (*Fig. 9*). All three are great coincident indicators of their respective actual quarterly S&P 500 variables, with the notable exception of missing their marks during recessions.

(FYI: "Forward earnings" and "forward revenues" are the time-weighted averages of industry analysts' consensus per-share estimates for this year and next. The time weighting makes a useful proxy for expected results over the next 52 weeks. We calculate "forward margins" from forward earnings and revenues. The "forward P/E" is simply the P/E using forward earnings.)

(5) *Forward looking.* While some companies provided cautious guidance about the rest of this year during their Q1 earnings reporting calls, plenty issued guidance that was upbeat. So on balance, the analysts' 2022 and 2023 operating earnings-per-share estimates continued rising in record-high territory through the May 19 week, with the growth rates for each stabilizing around 10.0% in recent weeks (*Fig. 10* and *Fig. 11*).

As a result, S&P 500 forward earnings rose to yet another record high of $237.56 per share during the May 19 week. Our bullish target for this variable is $255 at the end of this year. Given that forward earnings capture estimates for the next 12 months, $255 is also our forecast for analysts' 2023 forecast at the end of this year. Our forward earnings target is $275 at the end of next year, which is our forecast of their estimate for 2024 at that time (*Fig. 12*). (See *YRI S&P 500 Earnings Forecasts*.)

We are relatively confident about our forecasts of the analysts' forecasts of earnings. That's barring a mild recession, which we now assign 40% odds. The tricky part is projecting the valuation multiple. Under the circumstances (i.e., the Fed has just recently started its monetary tightening cycle), we reckon that the forward P/E ranges should be 15.0-17.0 this year and 16.0-18.0 next year.

Here are the beauty contestants—i.e., potential targets for the S&P 500 price index at the end of this year and next year, using our forward earnings forecasts of $255 and $275 and assuming various possible forward P/Es: 14.0 (3570, 3850), 15.0 (3825, 4125), 16.0 (4080, 4400), 17.0 (4335, 4675), 18.0 (4590, 4950), and 19.0 (4845, 5225). You be the judge. (To clear up any confusion, we should note that the projections above do not depend on our own forecasts for earnings in 2022 and 2023. Rather, they depend on our forecasts of analysts' consensus earnings estimates for 2023 at the end of 2022 and for 2024 at the end of 2023. See our *S&P 500 Earnings, Valuation & the Pandemic: A Primer for Investors*.)

In our opinion, the S&P 500 will remain volatile below its January 3 record high for the rest of this year, before climbing to new highs in 2023 and 2024.

(6) *Two market mavens.* Of course, there are lots of other methods for predicting the stock

market, especially on a short-term basis. I particularly enjoy monitoring the trading views of Joe Feshbach and Michael Brush. Joe called the recent upside reversal in the S&P 500, as we reported in our May 18 *Morning Briefing*. Joe thinks the index has a chance of continuing to surprise on the upside, retesting the prior area of failure at 4300. However, he was somewhat disappointed by Friday's drop in the put/call ratio to only 0.49.

Michael is one of the top analysts of insider-buying activity for trading purposes. On Thursday morning of last week, he observed that Wednesday was the best day of such activity of the prior eight business days. He viewed that as an "unambiguous buy signal."

Strategy III: Rising Recession Risk. Increasing the difficulty of predicting the stock market this year have been rising concerns about a recession. We share those concerns, which is why we raised our odds of a modest downturn from 30% to 40% in last Wednesday's *Morning Briefing*.

Investors' concerns have been most evident in plunging valuation multiples, as discussed above. Higher inflation and interest rates have a negative impact on valuation multiples by putting upward pressure on the stock market's earnings yield, thus lowering the P/E. But valuation multiples plunge along with earnings during recessions even if inflation and interest rates are falling. Fears of a recession weigh on valuation multiples, indicating that investors aren't willing to pay as much as before for the still-optimistic earnings forecasts of industry analysts, who simply don't see recessions coming until they've arrived.

As noted above, the key earnings variable for us in the stock market equation (i.e., P/E x E) is S&P 500 forward earnings. Because industry analysts don't see recessions coming, this variable tends to fall when it is obvious to everyone that a recession is underway. However, the growth rate in forward earnings on a y/y basis is highly correlated with numerous macroeconomic variables that can be projected and used to assess the near-term outlook for forward earnings.

Last week, we didn't like what we saw in the regional business surveys conducted by five of the Federal Reserve district banks, which is one of the main reasons we raised the odds of a recession. So far, four of the five are available through May—New York, Philadelphia, Richmond, and Kansas City—with Dallas' to be released today. Consider the following:

(1) First, we observe that the growth rate in forward earnings is highly correlated with the national M-PMI compiled by the Institute for Supply Management (*Fig. 13*). Their cycles are very similar, for sure. Forward earnings growth peaked at 42.2% y/y during the July 29,

2021 week, falling to 20.1% during the May 19, 2022 week. The M-PMI hit a recent cyclical peak of 63.7 during March 2021, falling to 55.4 this April. Both have declined in lockstep since their peaks.

(2) The average of the general business indexes of the four regional business surveys that are available through May is highly correlated with the national M-PMI (*Fig. 14*). The former dropped from a cyclical high of 32.9 during April 2021 to just 1.3 during May, the lowest reading since May 2020.

(3) In other words, May's reading of the average of the four regional business indexes suggests that the M-PMI fell closer to 50.0 during the month and that the growth rate of forward earnings is very likely to decelerate further (*Fig. 15*).

(4) Given the above, it's not surprising to see that the yearly percent change in the S&P 500 stock price index is highly correlated with both the M-PMI and the average of the four regional indexes (*Fig. 16* and *Fig. 17*). The latest reads of these two macro variables are consistent with a stock market that is no higher than it was a year ago, i.e., about 4200 on the S&P 500.

(5) Then again, on the near-term bullish side, contradicting May's drop in the regional business surveys was May's Markit flash M-PMI, which remained high at 57.5. The S&P 500 may be oversold relative to the economic fundamentals if the final M-PMI confirms the flash reading. We will see on June 1 when May's M-PMI is released.

US Consumers: Purchasing Without Purchasing Power. Another reason to be concerned that our soft landing for the economy could turn into a mild recession is that consumers' purchasing power is getting eroded by inflation. However, consumers have tapped into the excess personal savings they accumulated during 2020 and 2021 to boost their spending. That's not sustainable. And if labor market conditions start to weaken soon, they might run out of excess savings at a particularly unfortunate time. Consider the following:

(1) *Real personal income.* Inflation-adjusted personal income is down 3.5% y/y through April (*Fig. 18*). Excluding government social benefits to persons, it is up but just by 2.0% y/y through April. To boost their purchasing power, consumers have reduced their personal saving to $0.8 trillion (saar) during April, the slowest pace since the end of 2013 (*Fig. 19*). Nevertheless, over the past 24 months through April, personal saving has totaled $2.3 trillion.

(2) *Real personal consumption.* During April, inflation-adjusted consumer spending rose 0.7% m/m and 2.8% y/y (*Fig. 20*). The slowdown in spending on goods has been offset by a pickup in spending on services, with the former down 2.9% y/y while the latter is up 5.9% y/y. By the way, real consumer spending growth was revised up from 2.7% (saar) to 3.1% in Q1's real GDP report. The Atlanta Fed's *GDPNow* model shows Q2 real consumer spending tracking at a very solid 4.7% (saar) rate.

(3) *Jobless claims.* Weekly initial unemployment claims bottomed at a recent low of 166,000 during the March 19 week, which was the lowest since late 1968 (*Fig. 21*). They rose to 210,000 during the May 21 week. The labor market remains hot, but it may also be starting to show signs of cooling off.

US Inflation: Ups & Downs. Debbie and I continue to expect that the headline PCED inflation rate will moderate from its recent peak of 6.6% during March to 3.0%-4.0% next year. It was 6.3% during April. We are reasonably confident that much of that decline will be attributable to durable goods inflation. We are also reasonably confident that some of that improvement will be offset by rising rent inflation. We expect food and energy prices to moderate, but we have much less confidence in that outlook. Consider the following:

(1) *Durable goods.* Again, we are quite sure that the PCED inflation rate for consumer durable goods peaked at 11.5% y/y during January (*Fig. 22*). It was down to 8.4% during April. The 3-month annualized inflation rate for durable goods has been rising at a slower pace than the y/y comparison for the past three months and was down to -1.0% during April. Used car prices led on the way up and now are leading on the way down. But we also expect to see prices weaken for appliances and furniture as housing activity continues to slow. Here are the y/y and 3-month annualized percent changes in the PCED components for used cars (19.9%, -32.5%), new cars (13.7, 6.0), household appliances (12.1, 13.3), and furniture & home furnishings (13.6, 12.2).

(2) *Core nondurable goods.* The inflation rate for core nondurable goods (excluding food and energy) edged down to 3.1% y/y during April, but the 3-month annualized rate was 6.0%, exceeding the y/y comparison for six months in a row. Here are the y/y and 3-month inflation rates through April for some key core nondurables: clothing & footwear (5.7, 3.7), personal care products (2.5, 9.2), tobacco (7.2, 6.2), and prescription drugs (2.0, 0.7).

(3) *Core services.* The core PCED services inflation rate was 4.4% y/y through April, while the 3-month rate was 4.6%. Both have been relatively stable around these rates since late last year. Both are likely to move higher in coming months led by rent inflation.

Tenant rent and owners' equivalent rent account for 4% and 11% of the PCED. They account for 6% and 17% of PCED services. They were both up 4.8% y/y through April on rising trendlines since mid-2021 (*Fig. 23*). The 3-month for the former and latter were 6.3% and 5.4% through April. As we discussed in the May 24 *Morning Briefing*, rent inflation in the PCED is bound to move higher in coming months.

(4) *Food and energy.* The wild cards are the volatile food and energy components of the PCED. They were up 10.0% and 30.4% y/y, respectively, through April. And more disturbing is that their 3-month rates were 15.6% and 50.1% (*Fig. 24*).

The Biden administration's stated goal is to drive gasoline prices higher to force Americans to drive electric vehicles. On Monday, May 23, during a press conference in Japan, President Joe Biden said: "[When] it comes to the gas prices, we're going through an incredible transition …God willing, when it's over, we'll be stronger, and the world will be stronger and less reliant on fossil fuels…." The phrase "be careful what you wish for" comes to mind: Energy prices could remain high and also drive up the cost of food production during the "transition."

Movie. "Benjamin Franklin" (+ + +) (*link*) is an outstanding two-part, four-hour documentary produced by Ken Burns. Franklin was a self-taught entrepreneur who made revolutionary contributions in science, philosophy, politics, and diplomacy. Of course, he himself was one of America's foremost revolutionaries and founders. The documentary explains how America's war for independence from Britain was won to an important extent by his diplomatic efforts in obtaining French financial and military support. Also interesting is to see how Franklin was transformed from an Englishman into an American. He excelled at creating fake news to promote the cause of the American revolutionaries. His big failing was as a husband and a father. He was too busy being a Founding Father.

Calendars

US: Tues: Consumer Confidence 103.9; Chicago PMI 55.0; S&P/CS HPI Composite 20 City 20.0% y/y; Dallas Fed Manufacturing Index. **Wed:** Job Openings 11.4m; ISM M-PMI & Price Index 54.5/87.5; Construction Spending 0.5%; MBA Mortgage Applications; API Weekly Crude Oil Inventories; Beige Book; Williams; Bullard. (Bloomberg estimates)

Global: Tues: Eurozone CPI 0.6%m/m/7.7%y/y; Germany 2.25m; France GDP 0.0%;

France CPI 5.0% y/y; France Consumer spending 0.8%; Italy GDP -0.2%q/q/5.8%y/y; Italy CPI 6.2% y/y; Canada GDP 5.4%; Japan Household Confidence; Japan Housing Starts 3.0%; Australia GDP 0.7%q/q/3.0%y/y; China Caixin PMI; Balz; Watabe. **Wed:** Eurozone, Germany, France, Italy, and Spain M-PMIs 54.4/54.7/54.5/53.6/52.5; Germany Retail Sales 0.3%m/m/4.0%y/y; UK M-PMI 54.6; Australia Retail Sales; BOC Rate Decision 1.50%; Lagarde; Lane; Adachi. (Bloomberg estimates)

Strategy Indicators

Global Stock Markets Performance (*link*): The US MSCI index soared 6.5% last week for its first gain in eight weeks and its biggest rise since early November 2020. That gain snapped its longest losing streak since June 2011 when it fell for eight weeks. The index had narrowly averted a bear market on May 19 when it ended 19.7% below its record high on December 27. It finished Friday at 14.4% below its record. The US MSCI ranked fourth of the 48 global stock markets we follow in a week when 35 of the 48 countries rose in US dollar terms and the AC World ex-US index rose 2.6% to 16.6% below its June 15, 2021 record high. EMU was the best-performing region last week with a gain of 5.1%, ahead of EM Latin America (4.7) and EAFE (3.4). EMEA was the biggest underperformer with a decline of 0.3% followed by BIC (0.1), EM Eastern Europe (0.2), and EM Asia (0.2). Colombia was the best-performing country last week, rising 11.2%, followed by Chile (10.3), Spain (6.7), the US (6.5), and Peru (6.5). Among the 22 countries that underperformed the AC World ex-US MSCI last week, Hungary's 10.0% decline was the worst, followed by the Czech Republic (-4.0), Egypt (-3.3), Morocco (-1.5), and Pakistan (-0.7). The US MSCI's ytd ranking rose nine spots to 26/49, with its 13.9% decline remaining wider than the 12.9% drop for the AC World ex-US. EM Latin America has risen 16.8% ytd and is the only region outperforming the AC World ex-US. The laggards: EM Eastern Europe (-82.1), EMEA (-30.8), BIC (-20.5), EMU (-16.8), EM Asia (-16.6), and EAFE (-12.9). The best country performers so far in 2022: Chile (35.4), Jordan (22.6), Brazil (22.2), Colombia (21.3), and Peru (12.2). Apart from Russia, in which investors have lost 100.0% this year, here are the worst-performing countries ytd: Sri Lanka (-61.7), Hungary (-41.2), Egypt (-32.9), Pakistan (-27.6), and the Netherlands (-26.5).

S&P 1500/500/400/600 Performance (*link*): All three of these indexes soared by nearly similar amounts last week. LargeCap and SmallCap both gained 6.6%, just a hair ahead of the 6.5% rise for MidCap. LargeCap is now 13.3% below its record high on January 3. MidCap ended the week 12.7% below its record high on November 16, and SmallCap rose out of bear market to end the week 14.8% below its November 8 record high. All 33 sectors rose last week, up from 12 rising a week earlier and just six the week before that. SmallCap Energy was the best performer, with a gain of 16.8%, ahead of MidCap Energy (13.2%), LargeCap Consumer Discretionary (9.2), MidCap Materials (9.1), and MidCap Consumer Discretionary (8.9). SmallCap Utilities was the biggest underperformer last week, albeit with a gain of 1.4%, followed by LargeCap Health Care (3.2), MidCap Utilities (3.5), LargeCap Communication Services (3.6), and SmallCap Health Care (3.6). In terms of 2022's ytd performance, all three indexes are down ytd, and LargeCap continues to trail the SMidCaps in the performance derby. MidCap is down 10.6% ytd, less than the declines for SmallCap (-10.9) and LargeCap (-12.8). Just seven of the 33 sectors are positive so far in 2022, up from four a week earlier. Energy continues to dominate the top performers: SmallCap Energy (64.8), LargeCap Energy (58.3), MidCap Energy (48.0), LargeCap Utilities (4.7), and Midcap Materials (4.5). The biggest ytd laggards: LargeCap Consumer Discretionary (-25.5), LargeCap Communication Services (-24.9), SmallCap Consumer Discretionary (-22.4), SmallCap Health Care (-21.1), and MidCap Consumer Discretionary (-19.7).

S&P 500 Sectors and Industries Performance (*link*): All 11 S&P 500 sectors rose last week and four outperformed the composite index's 6.6% rise. That compares to a 3.0% decline for the S&P 500 a week earlier, when three sectors rose and seven outperformed the index. Consumer Discretionary was the top performer with a 9.2% gain, followed by Energy (8.1%), Tech (8.1), and Financials (8.0). The worst performers, albeit with gains: Health Care (3.2), Communication Services (3.6), Utilities (5.0), Real Estate (5.8), Materials (5.9), Consumer Staples (6.2), and Industrials (6.3). The S&P 500 is down 12.8% so far in 2022 with seven sectors ahead of the index, but just two in positive territory. The best performers in 2022 to date: Energy (58.3), Utilities (4.7), Consumer Staples (-3.3), Materials (-3.8), Health Care (-5.1), Financials (-9.2), and Industrials (-10.0). The ytd laggards: Consumer Discretionary (-25.5), Communication Services (-24.9), Tech (-19.2), and Real Estate (-13.7).

S&P 500 Technical Indicators (*link*): The S&P 500 rose 6.6% last week and improved relative to its 50-day moving average (50-dma) and its 200-day moving average (200-dma). However, the index closed below its 50-dma for a seventh week after four weeks above and closed below its 200-dma for the 14th time in 16 weeks. It had been above its 200-dma for 81 straight weeks through early February. The S&P 500's 50-dma moved lower for a seventh week as the index improved on Friday to 2.7% below its falling 50-dma from a 26-month low of 9.5% below on May 19. That's down from a 27-week high of 4.9% above its rising 50-dma in early November. The index had been mostly trading above its 50-dma since late April 2020; in June 2020, it was 11.7% above, which was the highest since its record high of 14.0% in May 2009. That compares to 27.7% below on March 23, 2020—its lowest reading since it was 29.7% below on Black Monday, October 19, 1987. The price index closed Friday at 6.8% below its falling 200-dma, up from a 26-month low of 12.8% below on May 19. The latest reading is down sharply from 10.8% above its rising 200-dma in early November. That compares to 17.0% above in December 2020, which was the highest since November 2009 and up from the 26.6% below registered during the Great Virus Crisis on March 23, 2020—the lowest reading since March 2009. At its worst levels of the Great Financial Crisis, the S&P 500 index was 25.5% below its 50-dma on October 10, 2008 and 39.6% below its 200-dma on November 11, 2008.

S&P 500 Sectors Technical Indicators (*link*): Just three of the 11 S&P 500 sectors traded above their 50-dmas last week, up from one a week earlier as Materials and Utilities joined Energy in that club. Four sectors have a rising 50-dma, unchanged from a week earlier as Consumer Staples turned up w/w and Health Care turned down. The two other members of the rising 50-dma club are Energy and Utilities. Looking at the more stable longer-term 200-dmas, five sectors are above, up from two a week earlier as Consumer Staples, Health Care, and Materials turned positive and joined Energy and Utilities as the only sectors above their 200-dmas. For perspective, at the depths of the Great Virus Crisis in April 2020, Health Care was the only sector trading above its 200-dma. Four sectors have a rising 200-dma, up from two a week earlier as Consumer Staples and Materials turned up w/w. The other members of the rising 200-dma club are Energy and Utilities.

US Economic Indicators

Personal Income & Consumption (*link*): Personal income was slightly short of expectations in April, while personal spending continued to expand at a robust pace. Both nominal and real personal consumption expenditures continued to set new record highs in April, increasing 0.9% and 0.7%, respectively. In real terms, spending on both goods (1.0%) and services (0.5) were in the plus column, with the latter climbing to a new record high; real goods consumption posted its first back-to-back gain in six months, after falling 1.9% during the four months through February. Turning to income, nominal (0.4%) and real personal income (0.2) rose in April, with the former up 2.6% y/y and the latter down 3.5%—depressed by high inflation. Meanwhile, nominal wages & salaries continued to reach new record highs in April, increasing for the 23rd month since bottoming in April 2020; it was up 0.6% m/m and 28.8% over the period. In real terms, wages and salaries rebounded 0.3% in April and 5.1% y/y to a new record high, after falling in March (-0.2) for the first time since

February 2021. The headline PCED increased 6.3% y/y in April, with core prices up 4.9%.

Personal Consumption Deflator (***link***): April's PCED advanced 0.2%, slowing considerably from March's 0.9%—which was the most since September 2005—following gains of 0.5% during each of the prior three months, while core prices rose 0.3% for the third month after averaging monthly gains of 0.5% the previous four months. The yearly headline rate was up 6.3% y/y, slowing from March's 6.6%—which was the highest since January 1982; it was at 3.6% a year ago. The core rate eased for the second month to 4.9% y/y after accelerating to 5.3% in February—which was the highest since January 1983. The three-month core rate slowed to 3.9% (saar) during the three months through April, easing steadily from December's 5.9%. Prices for durable goods fell 1.0% (saar) over the three months through April, the first negative reading since December 2020, down from a recent peak of 11.5% at the end of last year, while the increase in core nondurable goods prices advanced 6.0% (saar) over the comparable period, slowing from February's 8.6%. Meanwhile, prices for services ex energy accelerated 4.6% during the three months through April from 3.9% during March and February. Looking at the three-month percent changes in PCED components through April, annualized, prices fell for used cars & trucks (-32.5%, saar), video, audio & information processing equipment (-8.6), sports & recreational vehicles (-2.7), and physicians' services (-1.0). The following prices have heated up: airfares (97.1), car & truck rentals (66.6), lodging away from home (33.7), food & nonalcoholic beverages purchased off-premises (16.9), professional & other services (13.3), food services & accommodations (7.9), tenant rent (6.3), and owner-occupied rent (5.4). Prices have slowed over the three months through April for: gasoline (77.6), household appliances (13.3), furniture & home furnishings (12.2), recreation services (4.4), clothing & footwear (3.7), prescription drugs (0.7), and hospitals (0.1).

Consumer Sentiment Index (*link*): Consumer sentiment sank to an 11-year low in May, with both the present situation and expectations components heading south and the former dropping to its lowest level since March 2009. High inflation remains a major concern for consumers, though it was encouraging to see a slight easing in May's one-year expected inflation rate to 5.3% from 5.4% the prior two months, while the five-year expected inflation rate continued to move sideways at 3.0%. The Consumer Sentiment Index sank 6.8 points in May to 58.4, more than reversing April's 5.8-point rebound, dropping to its lowest level since August 2011; it's considerably below its pre-pandemic reading of 101.0. The present situation component dropped for the fourth time this year, by 6.1 points in May and 10.9 points over the period to 63.3, while the expectations component contracted 7.3 points to 55.2 in May after rebounding 8.2 points in April from the 14.0-point drop the first three months of this year. The present situation and expectations components were at 114.8 and

92.1, respectively, during February 2020. Joanne Hsu, the director of the consumer survey noted, "The recent drop in sentiment was largely driven by continued negative views on current buying conditions for houses and durables, as well consumers' future outlook for the economy, primarily due to concerns over inflation." She went on to observe that consumers were less pessimistic over future prospects for their personal finances than over future business conditions—with a majority of consumers expecting their financial situation to improve over the next five years, which may currently be supporting consumer spending. Still, she warns that persistently negative views of the economy may influence consumer behavior in the future.

Regional M-PMIs (*link*): Regional M-PMIs (link): Four Fed districts (New York, Philadelphia, Richmond, and Kansas City) have reported on manufacturing activity for May and show the manufacturing sector slowing to a near standstill. The composite index fell to 1.3 in May after accelerating from 12.3 in February to 20.3 in April, with activity in both the New York (to -11.6 from 24.6) and Richmond (-9.0 from 14.0) regions swinging from expansion to contraction, while the Philadelphia (2.6 from 17.6) area experienced a notable slowdown. Meanwhile, Kansas City (23.0 from 25.0) billings continued to increase at a robust pace. Orders (3.1 from 14.7) growth in May expanded at one-fifth April's rate, as billings in the New York (-8.8 from 25.1) area contracted for the third time this year, while orders in the Richmond (-16.0 from 6.0) area contracted for the second time; Philadelphia (22.1 from 17.8) and Kansas City (15.0 from 10.0) billings remained robust. Employment (20.4 from 22.4) growth remains solid, with hirings at Kansas City (34.0 from 19.0) and New York (14.0 from 7.3) factories basically double April's pace, while hirings in Philadelphia's (25.5 from 41.4) slowed, though were nearly double New York's rate. Hirings in the Richmond (8.0 from 22.0) region ran at roughly a third of April's rate.

Regional Prices Paid & Received Measures (*link*): We now have prices-paid and -received data from the Philadelphia, New York, Richmond, and Kansas City regions. (Note: The Philadelphia, New York, and Kansas City measures are diffusion indexes, while Richmond's measures are average annualized inflation rates—which we multiply by 10 for easier comparison to the other regional measures.) The prices-paid measure for the Richmond (151.3 from 118.3) region soared to a new record high, while the New York (to 73.7 from 86.4) measure slowed from April's record high. Meanwhile, Philadelphia's (78.9 from 84.6) also eased from its April rate—which was the highest since mid-1979 (85.4). It was at a record high of 91.1 during March 1974. Kansas City's (72.0 from 83.0) continued to remain below its record high of 88.0 posted a year ago. As for prices-received indexes, New York's (45.6 from 49.1) gauge eased for the second month from March's record high of 56.1, while Kansas City's (42.0 from 57.0) eased from its record reading in April.

Philadelphia’s (51.7 from 55.0) measure slowed for the first time in four months; it was at 62.9 in November—which was close to its record high of 63.8 in the mid-1970s—while Richmond’s (95.7 from 89.3) gauge accelerated this month, though was below January’s record high of 112.7.

Pending Home Sales (*link*): “Pending contracts are telling as they better reflect the timelier impact from higher mortgage rates than do closings,” said Lawrence Yun, NAR's chief economist. The Pending Home Sales Index (which tracks sales when a contract is signed but the transaction has not yet closed) contracted in April for the sixth month, by 3.9% m/m and 18.9% over the period to 99.3, the lowest since April 2020 and the 11th consecutive month of negative year-over-year readings; these sales were 9.1% below last April’s level. Sales fell in three of the four regions in April, with all down y/y. Here’s a regional look at pending home sales in April: Midwest (+ 6.6% m/m & -2.8 y/y), West (-4.3 & -10.5), South (-4.7 & -10.3), and Northeast (-16.2 & -14.3). Yun noted that “escalating mortgage rates have bumped the cost of purchasing a home by more than 25% from a year ago, while steeper home prices are adding another 15% to that figure.” Yun when on to say that with mortgage rates rising, existing home sales are likely to decline by 9.0% this year, while he expects home appreciation to slow to 5.0% by year-end from double-digit rates.

Global Economic Indicators

Eurozone Economic Sentiment Indicators (*link*): The Economic Sentiment Index (ESI) for the EU (-0.5 points to 104.1) continued to fall in May, down 12.0 points from its recent high of 116.1 in October. Meanwhile, the ESI for the Eurozone (+0.1 to 105.0) ticked up this month, after falling five of the prior six months by 12.5 points. Among the largest EU economies, Spain (+4.1 to 104.3) posted by far the biggest gain, followed by France (+1.5 to 103.7) and Italy (+0.8 to 106.3). Sentiment was little changed in Germany (+0.2 to 107.4) and fell in Poland (-,0.8 to 97.8) and the Netherlands (-1.2 to 103.0). For the overall EU at the sector level, industry confidence deteriorated for fourth time this year, from 12.8 in December to a 14-month low of 5.2 this month, with the current level of overall orders the weakest in two years. Consumer confidence remained entrenched in negative territory, posting its eighth consecutive decline in May and sinking 16.3 points over the eight-month period to -22.2. Confidence readings for the remaining sectors were little changed in May, with retail trade (+0.1 to -2.8) and services (+0.1 to 14.3) confidence up a tick and construction (-0.1 to 4.9) confidence down a tick.

Contact us by *email* or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-228-9102