MORNING BRIEFING
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MegaCap-8, Strikes & Hydrogen

Check out the accompanying chart collection.

Executive Summary: How the mighty have fallen. We're talking about the eight large-capitalization stocks dubbed the "MegaCap-8," which collectively—and most individually—have sorely underperformed benchmarks. When these behemoths swoon, most Growth portfolios feel the thud. … Also: Unions are up in arms over wages that aren't surging as fast as inflation, and they're feeling empowered by the tight labor market. Strikes may be coming. Jackie looks at some hot spots in various industries. … And: Don't dismiss hydrogen as a green alternative to fossil fuels. It's starting to look like the go-to fuel source for energy-intensive industrial processes.

Technology: MegaCap-8 Leading Tech Lower. The elevated inflation readings in Tuesday's CPI report caused continued MegaCap-8 stock price deflation. The specter of harsher-than-expected Fed tightening is no friend to these high-valuation tech stocks. Once high-flying market leaders, the MegaCap 8—i.e., Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Netflix, Nvidia, and Tesla—collectively has fallen far harder than the broader market in recent days.

Collectively, the MegaCap-8 lost 6.1% on Tuesday and 27.2% ytd through Tuesday's close—greater than the comparable declines experienced by the S&P 500 (-4.3%, -17.5%, respectively) and the S&P 500 Technology sector (-5.3%, -24.5%) (*Fig. 1* and *Fig. 2*). Individually, only two of the eight outperformed the S&P 500 over one or both of those time spans, Tesla by just hairs and Apple only ytd: Netflix (-7.8%, -63.8%), Nvidia (-9.6, -55.4), Meta Platforms (-9.4, -54.5), Alphabet (-5.9, -27.2), Microsoft (-5.4, -25.1), Amazon (-7.0, -23.9), Tesla (-4.2, -17.1), and Apple (-5.9, -13.4).

Despite its decline over the past year, the MegaCap-8 still makes up 23.1% of the S&P 500's market capitalization as of Tuesday's close. That's down from a peak of 26.4% on November 19, 2021. It's particularly tough for Growth style investors to avoid these large-cap stocks, which represent nearly half of the S&P 500 Growth index's market capitalization (*Fig. 3*).

While each of the MegaCap-8 members has taken it on the chin, the ytd performances of Meta Platforms, Netflix, and Nvidia stocks have been particularly devastating. Earnings forecasts for those companies have been sharply pared back after various Q2 missteps: Meta Platforms' advertising revenue declined, Netflix shed subscribers, and Nvidia's earnings growth was hurt by the drop in semiconductor chip sales for gaming PCs.

Analysts' expectations for the group of eight have become more realistic in the wake of dour earnings news and the stock market selloff. Analysts project long-term (typically three to five years) earnings growth for the MegaCap-8 collectively of 18.6%, down from the peak 38.9% that analysts forecast on April 26, 2019 (*Fig. 4*). Here's the long-term earnings growth analysts expect today and what they expected in 2019: Tesla (52.3%, 65.4%), Amazon (33.3, 94.0), Nvidia (23.4, 6.7), Microsoft (15.2, 15.0), Alphabet (13.7, 17.6), Apple (8.8, 13.0) Netflix (7.7, 49.0), and Meta (4.9, 19.1) (*Fig. 5*).

As forward earnings expectations deflated, so too did forward P/Es (i.e., the share price divided by forward earnings, which is the time-weighted average of analysts' consensus operating earnings-per-share estimates for this year and next). Following Tuesday's selloff, the MegaCap-8's forward P/E is 25.2, down from a peak of 38.5 on August 28, 2020. The S&P 500's forward P/E of 16.9 as of last Friday declines 1.9 points to 15.0 when these eight stocks are excluded (*Fig. 6*). During August 2020, the MegCap-8 had added 3.0 points to the S&P 500's P/E of 22.9. Sometimes, the forward P/E has fallen in recent years because the company started to produce earnings, as was the case with Tesla. But in other situations, the P/E shrank because the stock price fell sharply, as was the case with Netflix and Meta. In nearly all cases, their forward revenue and earnings growth expectations have slowed considerably.

Here are the forward P/Es for the MegaCap-8 members today and on August 28, 2020 when the MegaCap-8 forward P/E peaked: Amazon (72.0, 85.1), Tesla (53.9, 163.2), Nvidia (31.9, 51.7), Microsoft (23.8, 34.7), Apple (23.9, 32.6), Netflix (20.6, 66.1), Alphabet (14.3, 31.2), and Meta (14.3, 31.1) (*Fig. 7*).

In the couple of years prior to the peaks—i.e., from 2017 through 2019—the MegaCap-8's collective forward P/E bounced around 24. If valuations revert to that level from 25.2 on Tuesday, the group's shares would have a bit further to fall, but the distance from that possible foothold is narrower than it's been for the past two years, since the start of 2020, when the forward P/E was bouncing around 31 (*Fig. 8*).

US Economy: Keeping An Eye On Labor. With the unemployment rate near historical lows and inflation running hot, unions are pushing for higher wages and better benefits. Railroad conductors across the country, teachers in Seattle, and nurses in Minnesota are on strike or threatening to strike. Tuesday's report on consumer prices strengthened their requests for higher wages, with headline CPI rising 8.3% y/y in August and the core CPI increasing 6.3% (*Fig. 9*).

On the other hand, some companies whose employees aren't represented by unions have started announcing layoffs. That's particularly true among tech and fintech companies that aren't profitable and looking to reduce costs. Most recently, software developer Twilio announced plans to cut about 11% of its workers. Job reductions are also occurring at Goldman Sachs, which is facing slow investment banking activity; Best Buy, which warned that electronics sales have faltered; and Ford, which is restructuring its shop to focus on electric vehicles.

Here's a look at some of recent actions announced or threatened by unions:

(1) *Off the rails.* Railroads could stop rolling down the tracks on Friday if management and two unions, representing 57,000 conductors and engineers, can't reach an agreement on attendance policies. The railroads already have reached contract agreements with 10 other unions; but if the two recalcitrant unions go on strike, the other rail workers are expected to stay off the job as well.

The situation is becoming a political mess. After two years of unsuccessful negotiations, President Joe Biden appointed an emergency board in July to mediate. A White House panel recommended a 25% wage increase for workers between 2020 and 2025. Workers would receive a 14% wage increase immediately and five annual increases of $1,000, two of which would be made retroactively, a September 12 *WSJ* *article* reported.

In calls on Monday, President Biden pressed both sides to make a deal. And it's expected that the President and/or Congress would act quickly to end any strike that is declared. The railroads move about 30% of America's goods transported, as measured by ton miles (the length and weight freight travels), and a stoppage would severely disrupt the country's supply chain.

The potential for a strike is looking serious enough that contingency plans are being made. Amtrack, which runs on some freight lines, canceled some long-distance routes on Monday so passengers in transit wouldn't be stuck if a strike occurs. White House aides are looking at how essential products—like chlorine for wastewater treatment and coal for utility plants—that normally are carried by rail can be delivered if there's a strike, a September 13 *Washington Post* *article* reported. And some railroads have suspended transporting hazardous material shipments in preparation for a lockout.

(2) *Unhealthy relations.* About 15,000 nurses in 15 hospitals located in and around two Minnesota cities held a three-day strike that began on Monday in a push for higher wages and better staffing. Hospitals have offered a 10%-12% wage increase over three years, but the nurses want a wage increase of more than 30%, a September 12 ABC News *article* reported. “Hospital leaders called their wage demands unaffordable, noting that Allina and Fairview hospitals have posted operating losses and that the cost of such sharp wage increases would be passed along to patients,” the article noted. The nurses’ union declined to participate in mediation.

In Wisconsin, a separate group of nurses was expected to go on strike Tuesday before an agreement was reached with University of Wisconsin Hospitals and Clinics Authority. Nurses wanted the hospital to recognize their union—representing an estimated 2,600 of the 3,400 nurses the health care system employs—a September 12 *Milwaukee Journal Sentinel* *article* reported. Wisconsin has a law that eliminates most collective bargaining for public employees, but the nurses contend that UW Health is exempt. Hospital officials disagree. Now it’s up to the Wisconsin Employment Relations Commission to rule on the matter.

(3) *School’s out.* Classes started late in the Seattle area because 6,000 teachers and other school professionals were on strike. A tentative three-year contract was agreed upon late Monday night and now awaits union members’ vote.

The teachers are asking for improved staffing ratios in special education, greater mental health and behavioral resources, and higher wages. A summary of the new agreement showed union members would receive a 7% pay raise this year, 4% in year two, and 3% in year three. The raises could be higher if the state-funded adjustment is higher than what’s in the contract.

(4) *UPS unions eye 2023.* Contract negotiations between UPS and the Teamsters Union are expected to begin in the spring, prior to the contract’s expiration on August 1, 2023. The union’s president won his position by promising to take a harder line, leading some labor experts to predict a coming strike, a September 6 CNN *article* reported.

If the approximately 350,000 UPS drivers and package sorters in the union do strike, it will be the largest strike against a single business in US history. The average pay for delivery drivers is $95,000 a year, in addition to benefits that include a traditional pension plan. The majority of the workers who voted on their 2018 contract voted against it. But not enough workers voted to trigger a strike.

"Do our members wake up every day wanting a strike. I'd say no. But are they fed up? Yes, they're fed up," Union President Sean O'Brien told CNN. "Whether or not there is a strike, that's totally up to the company. We're going to utilize as much leverage as we can to get our members the contract they deserve." Them's fighting words.

Disruptive Technologies: Harnessing Hydrogen. Even before Russia choked off natural gas supplies to Europe, hydrogen was getting second and third looks by folks wanting a clean fuel source to power industrial processes. Hydrogen is one of the most abundant elements on Earth and burns cleanly. Yes, the gas is challenging to store. But NASA uses molecular hydrogen to send vehicles into space because it produces more energy for its weight than gasoline or coal. That's what makes it a good fuel source for energy-intensive industrial processes and moving large items like trains and ships.

Here's a rundown of some of the latest users and producers of hydrogen:

(1) *Using hydrogen on the high seas.* *Zero Emission Industries* has developed hydrogen fuel cells to power large ships. Its first vessel, the *Sea Change*, is being used as a ferry to transport passengers along the San Francisco waterfront. Zero Emission recently received funding led by Chevron New Energies and Crowley. The company believes its hydrogen-based fuel cells can be used to power cruise ships, yachts, tugboats, port equipment, and container ships, among other things.

The *Sea Change* went into service this year, but it follows in the wake of a hydrogen-fueled ferry in Norway. The *MF Hydra* was built for Norled at Westcon Yards and designed by LMG Marin.

(2) *Using hydrogen to roll down the tracks.* Fourteen hydrogen-powered trains have begun operating in Germany. Built by Alstom, the trains use Cummins fuel cell systems and can operate all day on one hydrogen tank before being fueled overnight at the Linde hydrogen filling station, an August 26 *article* in *PV Magazine* reported. Another 27 trains are on order for use in the Frankfurt area.

(3) *Using hydrogen in recycling plants.* UK-based Romco Metals plans to expand its metals recycling operation in Africa and is working on a project to create green hydrogen to power the furnaces, a September 13 Reuters *article* reported. The company would use solar

power to split water into its hydrogen and oxygen components.

(4) *Making hydrogen in Germany.* It took about one year for Siemens Smart Infrastructure to build one of Germany's largest green hydrogen generation plants, Fuel Cells Works *reported* on September 14. Green hydrogen is generated through electrolysis using renewable power sources. The plant can generate up to 1,350 tons of green hydrogen annually using solar and wind power. The hydrogen can be used to power local glass and ceramics businesses, automotive suppliers, and a local sawmill. It can also be used in vehicles. The hydrogen will be transported by trucks to companies within a 200-kilometer radius of the plant. By 2030, 10 million tons of green hydrogen will be produced in the EU, the article states.

(5) *Making hydrogen in Scotland.* Scottish Power is building a green hydrogen plant in Suffolk that's expected to generate 100 megawatts of power by 2026, according to an August 26 *article* on the AZoCleantech site. The hydrogen produced is to be used to power trains, trucks, and ships. Scottish Power is also building a smaller plant near Glasgow that will be powered by an offshore windfarm. It's expected to generate enough hydrogen to power 1,300 trucks.

Calendars

US: Thurs: Retail Sales Total, Core, and Control Group 0.2%/0.1%/0.5%; Import Prices -1.2%; NY Empire State & Philadelphia Fed Manufacturing Indexes -13.0/2.8; Headline & Manufacturing Industrial Production 0.1%/0.1%; Capacity Utilization Rate 80.3%; Business Inventories 0.6%; Initial & Continuous Jobless Claims 226k/1.475m; Natural Gas Storage. **Fri:** Consumer Sentiment Index, Current Conditions, and Expectations 60.0/60.8/59.7; Baker-Hughes Rig Count. (Bloomberg estimates)

Global: Thurs: Eurozone Trade Balance –€20b; Germany WPI 0.5%; France CPI 0.4%m/m/6.5%y/y; China Retail Sales 3.5% y/y; China Industrial Production 3.8% y/y; China Fixed Asset Investment 5.5% y/y; China Unemployment Rate 5.4%. DeGuindos; McCall; Mauderer. **Fri:** Eurozone Headline & Core CPI 0.5%m/m/9.1%y/y & 0.5%m/m/4.3%y/y; European Car Registrations; UK Headline & Core Retail Sales -0.5%m/m/-4.2%y/y & -0.7%m/m/-3.4%y/y; BOE Quarterly Bulletin. (Bloomberg estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The BBR climbed to 1.15 this week after falling the prior three weeks from 1.64 (highest since early January) to 1.00 over the period. It was at 0.60 12 weeks ago, which was the lowest since the week of March 10, 2009's 0.56. Bullish sentiment rose to 32.4% this week after plunging 15.4ppts the prior two weeks from 45.1% to 29.7%—which was just a tick above the 26.5% reading 12 weeks ago representing the fewest bulls since early 2016. Meanwhile, bearish sentiment fell for the second week, to 28.4%, after climbing the prior two weeks from 27.5% to 30.1%. The correction count slipped to 39.4% this week after climbing the previous two weeks from 25.3% to 40.6%—which was the highest since early March 2020. In the meantime, the AAII Sentiment Survey (as of September 8) reports optimism about the short-term direction of the stock market fell below 20% for the first time in nine weeks, while pessimism climbed to an 11-week high. The percentage expecting stocks will rise over the next six months dropped for the third week by 15.2ppts (to 18.1% from 33.3%). The report notes this is the 25th lowest reading in the 35-year history of the series and below its historical average of 38.0% for the 42nd consecutive week. The percentage expecting stocks to fall over the next six months increased for the fourth week, by a total of 16.6ppts to 53.3%, following five weeks of decline, from 52.8% to 36.7%, which was the lowest since March 31 (27.5%). The measure has been above its historical average of 30.5% for 41 out of the past 42 weeks, with the report noting that it's at an unusually high level for the 26th time in 34 weeks. (The breakpoint between typical and unusually high readings is currently 40.5%.)

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin remained steady last week at 13.1%. That's up from a 13-month low of 13.0% at the end of August, but remains down from its record high of 13.4% achieved intermittently from March to June. Since the end of April 2020, it has exceeded its prior record high of 12.4% in September 2018. It's now up 2.8ppts from 10.3% during April 2020, which was the lowest level since August 2013. Forward revenues rose to a new record high, and forward earnings edged down less than 0.1% to 1.0% below its record high in mid-June. Both had been steadily making new highs from the beginning of March 2021 to mid-June; prior to that, they peaked just before Covid-19 in February 2020. The consensus expectations for growth and margins remained steady w/w as analysts await the Q3 earnings confession season. Forward revenues growth was steady w/w at a 23-month low of 5.7%. That's down from a record high of 9.6% growth at the end of May 2021. Still, that's up from 0.2% forward revenues growth during April 2020, which was the lowest reading since June 2009. Forward earnings growth was steady w/w at a 24-month low of 7.4%. 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 0.4ppt to 12.8%. They expect revenues to rise 12.0% (unchanged w/w) in 2022 and 4.1% in 2023 (unchanged w/w) compared to the 16.4% gain reported in 2021. They expect earnings gains of 9.7% in 2022 (unchanged w/w) and 7.2% in 2023 (unchanged w/w) compared to an earnings gain of 51.0% in 2021. Analysts expect the profit margin to drop 0.2ppt y/y to 12.8% in 2022 (unchanged w/w) from 13.0% in 2021 and to improve 0.3ppt y/y to 13.1% in 2023 (unchanged w/w). The S&P 500's weekly reading of its forward P/E rose 0.1pt w/w to 16.9 from a six-week low of 16.8. That compares to a 15-week high of 18.2 several weeks earlier and is up from a 26-month low of 15.8 in late June. That also 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 0.02pt w/w to 2.21 from a seven-week low of 2.19. That compares to a 15-week high of 2.38 several weeks earlier and is up from a 26-month low of 2.10 during June. That also 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 eight of the 11 S&P 500 sectors, forward earnings rise for four sectors, and the forward profit margin rise for five sectors. Nearly all of the sectors are below recent record highs in their forward revenues, earnings, and profit margins. Energy and Utilities are the only sectors with forward earnings at a record high now. Four sectors have forward revenues at a record high this week: Consumer Staples, Financials, Health Care, and Industrials. All sectors now have forward profit margins that are below their record highs, but those of Energy and Industrials remain closest to their post-pandemic highs. Energy still has forward revenues well below a record high, and Utilities' forward revenues and margin are lagging too. Only three sectors have posted a higher profit margin y/y so far during 2020: Consumer Staples, Tech, and Utilities; during 2021, all of the sectors but Utilities posted a y/y improvement. Seven sectors are expected to see margins decline y/y for full-year 2022, followed by four sectors in 2023. Here are 2022's decliners: Communication Services, Consumer Discretionary, Consumer Staples, Financials, Health Care, Information Technology, and Real Estate. Here's how they rank based on their current forward profit margin forecasts along with their record highs: Information Technology (24.7%, down from its 25.4% record high in early June), Financials (18.5, down from its 19.8 record high in August 2021), Real Estate (18.2, down 0.1ppt w/w and down from its 19.2 record high in 2016), Communication Services (15.3, down from its 17.0 record high in October), Utilities (13.9, down from its 14.8 record high in April 2021), S&P 500 (13.1, down from its record high of 13.4 achieved intermittently from March to June), Materials (12.8, down from its 13.6 record high in early June), Health Care (10.6, down from its 11.5 record high in early March), Industrials (10.3, down from its 10.5 record high in December 2019), Energy (12.2, down from its 12.3 record high in early August), Consumer Discretionary (7.5, down from its 8.3 record high in 2018), and Consumer Staples (7.3, down from its 7.7 record high in June 2020).

US Economic Indicators

Producer Price Index (*link*): The final demand PPI fell for the second month in August, after not posting a decline since April 2020, falling 0.1% following July's 0.4% decline. It averaged monthly gains of 1.1% the first half of this year. The yearly rate eased for the fifth month, since reaching a record high of 11.7% in March, dropping to 8.7% by August. Meanwhile, core prices—which excludes food, energy, and trade services—edged up only 0.2% last month after a 0.1% uptick in July, with the yearly rate slowing from a record-high 7.1% in March to a 14-month low of 5.6%. *Final demand goods* dropped 1.2% in August after dropping 1.7% in July—which was the biggest decline since April 2020—with over three-quarters of the August's decline attributable of a 12.7% plunge in gasoline prices. The yearly rate for final demand goods dropped 5.5ppts to 12.2% from June's record high of 17.7%. *Final demand services* rose 0.4%, double July's 0.2% rise, though the yearly rate eased for the fifth month since reaching a record-high 9.4% in March—slowing to a 10-month low of 6.6% in August. The *PPI for personal consumption* posted back-to-back declines, falling 0.1% in August following July's 0.5% drop, slowing the yearly rate to 7.6% from March's record-high 10.4%. The yearly rate for personal consumption excluding food & energy is also disinflating, easing from a record-high 8.1% in March to 5.8% last month. *Looking at pipeline prices*, pressures remain elevated, though have eased from recent highs. The yearly rate for intermediate goods prices eased to a 17-month low of 14.1% from a cyclical high of 26.5% in November, while the crude goods rate picked up a bit in August to 35.9% after slowing to a 17-month low of 30.4% in July; it peaked at 59.0% last April.

Global Economic Indicators

Eurozone Industrial Production (*link*): Headline production, which excludes construction, contracted in July for the first time since March, slumping 2.3% last month, after climbing

2.3% during the three months through June to its highest level since December 2017. July's decline was led by a 4.2% drop in capital goods output, which retraced a good portion of the 6.5% jump during the three months through June. Consumer durable (-1.6%) and intermediate (-0.8) goods production were also in the red in July, while consumer nondurable goods (1.2) and energy (0.4) output moved higher. Compared to a year ago, headline production was down 2.4%, pulled lower by declines in capital (-5.4% y/y), intermediate (-1.8), and consumer nondurable (-1.1) goods output versus a year ago, while consumer durable goods (1.4) and energy (1.1) output were above a year ago. Production data are available for the top four Eurozone economies and show only Italy (+0.4%) posted a gain in July, while output in France (-1.5), Spain (-1.0), and Germany (-0.7) fell. Over the 12 months through July, production was 4.9% higher in Spain, but below a year ago in Italy (-1.4%), France (-1.2), and Germany (-1.0).

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