MORNING BRIEFING
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Executive Summary: Our Monday webinars often don't allow time to answer all your questions. So today's *Morning Briefing* is devoted to a few recent ones. … We don't expect much economic impact when the drawdown of the SPR ends, as we don't foresee gasoline prices spiking as a result since tapping the SPR didn't contribute much to the decline in prices. … Also: We counter our skeptics who expect a rampant recession, explaining why we see greater odds (60%) that the gently rolling recession already underway will continue. … And: The strong dollar should peak when monetary policymakers' hawkishness does, to the relief of US companies with foreign-derived sales and earnings.

On Request. On Friday, we sent you a brief review of our research services titled "*Getting the Most From Yardeni Research*." We wrote: "We get some of our best research ideas from our accounts. If you ask us a question, don't be surprised if we provide our answer the following day in the *Morning Briefing*!" I also field questions during my Monday morning webcasts. But there are always a few more questions than our 30 minutes of time allows. In recent days, a bit of a backlog has accumulated. The following is a catch-up on these requests.

Energy: Will Santa Slip in the Oil Patch? Debbie and I are fielding more questions about the prospects for gasoline prices after the midterm elections and near the end of November, when the Biden administration's release of oil from the Strategic Petroleum Reserve (SPR) is set to end. The fear is that the pump price will go up a lot, depressing consumers' confidence and eroding their purchasing power. Soaring interest rates already have increased the risk of a recession. A renewed surge in fuel prices might very well push the economy over the edge. That's a valid concern.

While another jump in petroleum prices would be good for the S&P 500 Energy sector, it would be bad news for the rest of the stock market, as seen during the first half of this year. Even now through Friday's close, the only S&P 500 sector with a gain so far this year is Energy. Here is the ytd performance derby of the 11 sectors of the S&P 500 through Friday: Energy (57.9%), Health Care (-10.3), Consumer Staples (-10.7), Utilities (-11.6), Industrials (-16.2), Financials (-17.7), Materials (-20.1), S&P 500 (-21.3), Information Technology (-28.7), Consumer Discretionary (-30.2), Real Estate (-33.1), Communication Services (-

36.6). (See *Table 1*.)

Will the economy and the traditional year-end Santa Claus rally slip in the oil patch? As we've been observing lately, the stock market has had a remarkably consistent record of rallying in the months after every one of the 20 midterm elections since 1942. Will this record get tarred after the latest midterm election? We don't think so.

Consider the following:

(1) On March 31 of this year, the Biden administration announced the US will release 1 million barrels per day (mbd) of oil from the SPR for six months. So the program will terminate at the end of November just after the midterm elections.

The national retail pump price of a gallon of gasoline was $3.38 at the start of this year (*Fig. 1*). The Russians invaded Ukraine on February 23. The price of gasoline rose to $4.33 during the last week of March. It peaked at $5.11 during the June 13 week. It dropped to the year's low of $3.77 during the September 19 week. It edged up to $3.99 during the latest week of October 17. We don't expect it will surge once the SPR draw is over.

(2) The price of gasoline accounts for only 4.24% of the CPI and 2.73% of the PCED. Nevertheless, its rapid rise earlier this year was a major contributor to the jump in overall consumer inflation (*Fig. 2*). It also had a significant impact on consumers' purchasing power. During June, gasoline consumption totaled a record $541 billion (saar), up $159 billion from $382 at the start of this year (*Fig. 3*). The average US household spent an average of $2,988 on gasoline at a seasonally adjusted annual rate at the start of the year. That average rose to $4,223 during June (*Fig. 4*).

Another surge in gasoline prices would exacerbate inflation, possibly forcing the Fed to keep tightening monetary policy and eroding the purchasing power of consumers at the same time.

(3) Here's why we don't expect a rebound in gasoline prices: The US uses about 20.0mbd of petroleum products. The extra 1.0mbd from the SPR amounts to just 5% of daily US usage and about 1% of daily global oil production. So it is unlikely that dipping into the SPR contributed much to the drop in gasoline prices. Indeed, a July 26 *analysis* by the US Treasury Department estimated that "President Biden's historic SPR release, in coordination with IEA partners, lowered the price of gasoline by 17 cents to 42 cents per gallon, with an alternate approach suggesting a point estimate of 38 cents per gallon."

We've previously observed that the best cure for high gasoline prices is high gasoline prices. Sure enough, consumers responded to the high price in early July—i.e., just as the summer driving season was revving up—by reducing their usage of gasoline by around 1.0mbd through August (*Fig. 5*). During the October 14 week, they used 8.8mbd of gasoline, or about 400,000 barrels per day less than at the same time last year.

(4) The big story in the oil patch is that US crude oil and petroleum product exports rose to a record 10.2mbd during the October 14 week (*Fig. 6*). Exports increasingly have been exceeding US imports, which have been declining in recent weeks to 7.8mbd. As a result, net imports fell to a record -2.4mbd. If we subtract this amount from US petroleum products supplied (which is actually a measure of consumption), we see that the US is producing 2.4mbd more than it's using, which equals net exports (*Fig. 7*).

The actual data compiled by the US Energy Department showed that during August, US production (including crude oil field production, natural gas liquids, biofuels, and processing gain) totaled 20.2mbd, slightly exceeding the 20.1mbd of products supplied (*Fig. 8*).

(5) On October 11, JPMorgan CEO Jamie Dimon said that the US should pump more oil amid the world's energy crisis, just days after OPEC+ agreed to a production cut that is equivalent to 2% of the global supply. In a CNBC interview, he said that "America is the swing producer, not Saudi Arabia." We agree.

(6) Will we know whether the end of the SPR drawdown will boost gasoline prices when the program terminates at the end of November? Maybe not given President Biden's October 19 announcement that an additional 15 million barrels will be sold from the SPR in December and that the administration also will purchase oil to refill the SPR—now at its lowest level in nearly 40 years—when prices fall to $70 a barrel (*Fig. 9*). "Refilling the reserve at $70 a barrel is a good price for companies. And it's a good price for the taxpayers. And it's critical to our national security," Biden said. Needless to say, Biden's recent comments about his SPR policy are contradictory and confusing.

Recession: Rolling vs Rampant. Yesterday, we observed that the Index of Leading Economic Indicators peaked at a record high during February and fell 2.9% over the past seven months through September. It has been a reliable harbinger of recessions before. So have inverted yield curves, i.e., when the 2-year Treasury yield exceeds the 10-year yield, which has been the case since July. Jamie Dimon, Jeff Bezos, Stan Druckenmiller, and Leon Cooperman are warning about a recession in 2023.

We've observed that if a recession is coming, it will be the most widely anticipated downturn ever. Widespread preparation for it minimizes the chances of it, by reducing the shock effects seen when recessions catch people by surprise.

Not surprisingly, we've received emails from some skeptics. We counter by observing that the economy is already in a rolling recession, a.k.a. a growth recession or a soft landing. Consider the following:

(1) *Housing.* The single-family housing bust is well underway and is likely to bottom by the middle of next year given how quickly mortgage applications and single-family housing starts are falling, down 40.8% and 26.4% ytd (*Fig. 10*). On the other hand, multi-family starts remains strong and may remain so given the increase in rents and the unaffordability of homes for purchase.

(2) *Autos.* The auto industry's recovery from its supply-chain disruptions is likely to be thwarted by rapidly tightening credit conditions for auto loans. Last year and early this year, a shortage of auto parts reduced the industry's output. US motor vehicle sales fell to 12.7 million units (saar) during December 2021, down from 16.5 million units at the end of 2020. They've remained below 14.0 million units (saar) since May (*Fig. 11*).

At the end of September, Cox Automotive, which provides digital and software solutions for automotive dealers, reported in a *press release* that "new-vehicle sales are down more than 10% versus 2021 and are on course to finish at the lowest level in a decade." Cox lowered its full-year sales forecast to 13.7 million units. The press release reported that sales have been "held in check by high prices, tight inventory, and softening demand."

Higher interest rates are beginning to directly impact the new-vehicle market, knocking some buyers to the sidelines. Subprime buyers accounted for roughly 14% of the new-vehicle market in 2019. Now, subprime buyers account for just 5%, and deep subprime buyers have all but disappeared. However, there is still lots of pent-up demand for autos among high-income buyers who can pay cash or secure better loan rates.

(3) *Retailers, ports, and truckers.* Retailers have been scrambling for months to discount merchandise to reduce bloated inventories. Consumers aren't buying PCs and large flat-screen TVs now because they did so en masse during the pandemic. That's depressing consumer electronic sales and the demand for semiconductors.

The 12-month sum of inbound container traffic at the West Coast ports fell in September to the slowest pace since April 2021 (*Fig. 12*). This suggests that retailers have trimmed their orders for imported goods. On the other hand, the American Trucking Association truck tonnage index rose 5.4% y/y during September (*Fig. 13*). The trucking business continues to do well, as evidenced by the 10.5% ytd rise through September in medium-weight and heavy truck sales to 504,000 units (saar) (*Fig. 14*).

Of course, some of the weakness in consumers' demand for goods is attributable to their spending more on services, which took longer to become readily available than did goods following the pandemic lockdowns and restrictions. This was clearly evident in September's M-PMI, which was down to 50.9, while the NM-PMI remained elevated at 56.7 (*Fig. 15*).

(4) *Manufacturing & onshoring.* Another source of economic growth is likely to be the ongoing onshoring of supply chains. The semiconductor industry has received substantial financial support from Washington to bring production to the US from overseas. The government's recent restrictions on US semiconductor sales and related activity in China should also spur onshoring.

Over the past 24 months through August, US new orders for industrial, metalworking, and materials-handling machinery is up 63% compared to a 22% increase in new orders for construction, farm, and mining machinery (*Fig. 16*). We think that the strength in the former reflects onshoring activity.

(5) *Bottom line.* All of the above adds up to a rolling recession rather than a rampant one, in our opinion. Nevertheless, we aren't dismissing the risks of a severe economic downturn. As we wrote in our October 4 *Morning Briefing,* looking into 2023, we assign a 60% subjective probability to a soft landing and 40% to a hard landing.

The Dollar: How Much Stronger? How Much Longer? We don't usually get many questions about the foreign-exchange value of the US dollar. Recently, we have been getting more than usual since the dollar has been soaring all year.

The JP Morgan trade-weighted dollar is up 14% y/y through Friday's close (*Fig. 17*). The main concern, of course, is that the strong dollar is weighing on the corporate profits of companies with sales overseas. A company with 50% of its sales and earnings abroad would see a 12% drop in those earnings in dollars and a 6% drop in total earnings compared to a year ago given the current strength of the dollar.

A stronger dollar also tends to weigh on commodity producers headquartered in the US.

That's because their overseas sales and earnings are worth less in dollars, and because higher dollar prices for commodities priced in dollars depress demand for them. That's why a strong (weak) dollar tends to coincide with weak (strong) commodity prices.

Much of the dollar's strength this year reflects the more hawkish stance of US monetary policymakers to inflation than their counterparts in most other countries, especially in Europe and Japan. The dollar should peak once the Fed either pauses or terminates the current round of monetary policy tightening.

When that happens, companies with lots of overseas exposure, particularly commodity producers, should get boosts to their earnings and to their stock prices, at least relative to what they've been like during this strong-dollar period.

Calendars

US: Tues: Consumer Confidence 106.5; Richmond Fed Manufacturing Index; S&P Case-Shiller 20-City Composite 0.2%m/m/14.4%y/y; API Weekly Crude Oil Inventories; Waller. **Wed:** New Home Sales 585k; MBA Mortgage Applications; Goods Trade Balance Advance; Retail & Wholesale Inventories; Crude Oil Inventories & Gasoline Production. (Bloomberg estimates)

Global: Tues: Germany Ifo Business Climate Index, Current Assessment, and Expectations 83.3/92.5/74.9; UK CBI Industrial Trend Orders -13; Japan Core CPI 1.9% y/y; China GDP 3.5%q/q/3.4%y/y; China Industrial Production 4.5% y/y; China Retail Sales 3.3% y/y; China Fixed Asset Investment 6.0% y/y; China Unemployment Rate 5.2%; China NBS Press Conference; ECB Bank Lending Survey; Pill. **Wed:** France Consumer Confidence 77; Japan Leading & Coincident Indicators; China Industrial Profits; BOC Interest Rate Decision 4.00%; BOJ Outlook Report. (Bloomberg estimates)

Strategy Indicators

S&P 500/400/600 Forward Earnings (*link*): Forward earnings fell last week for all three of these indexes for a third straight week. LargeCap's forward earnings has fallen in 10 of the 17 weeks since it peaked at a record high in late June. Over the same time period, MidCap's has dropped 11 times, and SmallCap's moved lower 10 times. For a 17th straight week, none of these three indexes had forward earnings at a record high. However, forward earnings levels remain close to their record highs. LargeCap's is at a five-month low, but just 1.7% below its record high at the end of June. MidCap's is at a six-month low and 3.3% below its record high in early June; and SmallCap's is at an eight-week low and 2.7% below its record high in mid-June. Forward earnings momentum continues to fade. In the latest week, the yearly rate of change in LargeCap's forward earnings was down to a 19-month low of 8.5% y/y from 9.0%; that's down from a record-high 42.2% at the end of July 2021 and up from -19.3% in May 2020, which was the lowest since October 2009. The yearly rate of change in MidCap's forward earnings eased w/w to a 19-month low of 16.8% y/y from 17.4%. That's down from a record high of 78.8% at the end of May and compares to a record low of -32.7% in May 2020. SmallCap's was down w/w to a 19-month low of 13.9% y/y from 14.5%. That's down from a record high of 124.2% in June 2021. It had been at a record low of -41.5% in June 2020. Companies have been beating consensus estimates quite handily since the Q2-2020 earnings season, causing analysts' consensus earnings forecasts for 2022 to 2023 to improve instead of decline as is typical, but their forecasts are heading lower now for both years. Here are the latest consensus earnings growth rates for 2022 and 2023: LargeCap (6.7%, 7.5%), MidCap (14.1, 0.7), and SmallCap (10.8, 7.2).

S&P 500/400/600 Valuation (*link*): Valuations were higher last week after falling in six of the prior nine weeks. LargeCap's forward P/E jumped 0.7pt to 15.9 from 15.2, and is now 0.8pt above its 30-month low of 15.1 at the end of September. That compares to a 16-week high of 18.1 in early August and an 11-year low of 11.1 during March 2020. MidCap's forward P/E rose 0.4pt w/w to 12.0 from 11.6, up from a 30-month low of 11.1 at the end of September. That compares to a 16-week high of 13.2 in early August, a record high of 22.9 in June 2020, and an 11-year low of 10.7 in March 2020. SmallCap's forward P/E gained 0.4pt w/w to 11.3 from 10.9, up from a 14-year low of 10.6 four weeks earlier. That's down from a 16-week high of 12.8 in early August and compares to a record low of 10.2 in November 2009 during the Great Financial Crisis. That also compares to its record high of 26.7 in early June 2020 when forward earnings was depressed. LargeCap's forward P/E in February 2020—before Covid-19 decimated forward earnings—was 18.9, the highest level since June 2002. Of course, that high was still well below the tech-bubble record high of 25.7 in July 1999. Last week's level compares to the post-Lehman-meltdown P/E of 9.3 in October 2008. MidCap's P/E was below LargeCap's P/E yet again last week, as it has been for most of the time since August 2018. In contrast, it was last solidly above LargeCap's from April 2009 to August 2017; MidCap's current 25% discount to LargeCap is near its biggest since September 2000. SmallCap's P/E was below LargeCap's for a 114th straight week. That's the longest stretch at a discount since 1999-2002; SmallCap's current 29% reading is near its biggest discount since February 2001. SmallCap's P/E has been mostly above LargeCap's since 2003. Looking at SmallCap's P/E relative to MidCap's, it was at a discount for a 71st straight week; the current 5% discount is up from a 9% discount in December but remains near its lows during 2000-01.

S&P 500 Sectors Quarterly Earnings Outlook (*link*): Since the Q3-2020 earnings season, analysts as a whole have been raising their consensus forecasts for future quarters instead of lowering them as is the norm through the earnings warnings seasons. That six-quarter streak of positive revisions throughout the quarter officially ended with Q1-2022, and the declines have accelerated for Q3-2022. In the latest week, the Q3-2022 S&P 500 earnings-per-share forecast rose 31 cents w/w to $55.14 on the back of positive earnings surprises, but is now 7.3% below its $59.49 forecast at the start of the quarter. Analysts expect S&P 500 earnings growth to weaken to 2.3% y/y on a frozen actual basis and 3.1% on a pro forma basis. That's down from Q2-2022's 9.9% y/y gain on a frozen actual basis and 8.4% y/y on a pro forma basis. Double- and triple-digit percentage growth is expected for just four sectors in Q3-2022, and y/y declines are expected for seven. That compares to Q2-2022's count of four sectors with triple- and double-digit growth, three with a single-digit gain, and four with a y/y decline. Here are the S&P 500 sectors' latest blended earnings growth rates for Q3-2022 versus their Q2-2022 growth rates: Energy (118.0 in Q3-2022 versus 295.5% in Q2-2022), Industrials (27.3, 31.6), Consumer Discretionary (12.2, -12.1), Real Estate (10.9, 13.1), S&P 500 (3.1, 8.4), Consumer Staples (-0.8, 2.2), Information Technology (-3.4, 1.5), Health Care (-3.9, 8.7), Materials (-6.7, 17.5), Utilities (-8.0, -3.7), Communication Services (-11.2, -20.3), and Financials (-15.9, -19.3).

S&P 500 Q3 Earnings Season Monitor (*link*): The Q3-2022 earnings season is off to the poorest start of a quarterly reporting season since Q1-2020, assessed by the four surprise metrics we measure for both earnings and revenues. With nearly 20% of S&P 500 companies finished reporting revenues and earnings for Q3, revenues are ahead of the consensus forecast by just 1.3%, and earnings have exceeded estimates by 5.4%. At the same point during the Q2 season, revenues were 1.6% above forecast and earnings had beaten estimates by 4.5%. Excluding Financials, Q3's revenue surprise falls sharply to 1.1% from 1.3%, and the earnings surprise drops to 4.4% from 5.4%. For the 98 companies that have reported Q3 earnings through mid-day Monday, the aggregate y/y revenue and earnings growth rates have slowed from their readings from Q2-2021 to Q2-2022. The 98 reporters so far collectively has a y/y revenue gain of 7.4%, but an earnings gain of only 0.4%. Just 67% of the Q3 reporters so far has reported a positive revenue surprise, and 75% has beaten earnings forecasts. Furthermore, significantly fewer companies have reported positive y/y earnings growth in Q3 (57%) than positive y/y revenue growth (85%). These figures will change markedly as more Q3-2022 results are reported in the coming weeks, particularly from non-Financial firms with greater exposure to the strong dollar. While we expect y/y growth rates to remain positive in Q3, we think the revenue and earnings surprises will deteriorate q/q due to the slowing economy, missed deliveries, higher costs, and currency translation.

Global Economic Indicators

US PMI Flash Estimates (*link*): Business activity in the private sector contracted in October for the fourth month, according to flash estimates, though deteriorated this month after moving back near the breakeven point in September. The *C-PMI* fell to 47.3 this month, after climbing from 44.6 in August (the weakest since May 2020) to 49.5 in September. The *M-PMI* sank to a 28-month low of 49.9—the first reading below 50.0 since mid-2020 during the height of the pandemic—as orders contracted at the fastest pace in 29 months. The M-PMI was as high as 59.2 just six month ago. Meanwhile, manufacturers saw output rise for the second successive month, climbing to a five-month high of 50.7. The *NM-PMI* was in contractionary territory for the fourth month, falling to 46.6 this month after jumping from a 27-month low of 43.7 in August to 49.3 in September, reflecting weak client demand and rising inflation and interest rates. On the *inflation front*, price pressures in the service sector picked up a bit, due to higher food, energy, and staffing costs, while the goods-producing sector saw a slight cooling of price pressures.

Eurozone PMI Flash Estimates (*link*): “Eurozone economic contraction intensifies in October” is the headline of this month’s Eurozone PMI report. The *Eurozone’s C-PMI* eased for the sixth month from 55.8 in April to a 23-month low of 47.1, as the *M-PMI* plummeted from 58.7 in January to a 29-month low of 46.6 this month and the *NM-PMI* dropped from 57.7 in April to a 20-month low of 48.2. Looking at the two largest Eurozone economies, Germany’s private sector sank deeper into contractionary territory this month as energy costs continued to accelerate, impacting both business costs and demand, while France’s fell to the breakeven point between expansion and contraction. *Germany’s C-PMI* was in contractionary territory for the fourth month, falling to a 29-month low of 44.1 this month from 55.6 in February, with the NM-PMI sliding to a 29-month low of 44.9 and the M-PMI to a 28-month low of 45.7. Meanwhile, *France’s C-PMI* fell for the fifth time in six months, from a recent high of 57.6 in April to a 19-month low of 50.0 in August, as the M-PMI fell for the second month, to a 29-month low of 47.4, after improving from 49.5 to 50.6 in August, while the NM-PMI continued to hover just above 50.0 for the third month, falling from 52.9 to 51.3 this month. *Elsewhere across the region*, the report noted that output fell for the second consecutive month, falling at its fastest rate since January 2021—and since June 2013 excluding the pandemic-related drop. *Looking at inflation*, the report said that while supply shortages showed further signs of easing, inflationary pressure remained elevated amid high energy costs and upward wage pressures.

Japan PMI Flash Estimates (*link*): Activity in Japan's private sector moved further into expansionary territory for the second month, according to flash estimates, after contracting in August for the first time in six months. October's *C-PMI* climbed to a four-month high of 51.7 after sliding from a recent high of 53.0 in June to 49.4 in August. The report noted that "the recent easing in international border restrictions and the releasing of the Nationwide Travel Discount Program earlier this month boosted activity level and order book volumes." The *NM-PMI* moved up to 53.0 this month from 52.2 and 49.5 the prior two months, moving back toward its recent high of 54.0. Meanwhile, the manufacturing sector continued to struggle from weak demand and severe cost pressures, with the *M-PMI* sinking to a 21-month low of 50.7; it was at 55.4 at the start of this year. Business confidence dipped to a six-month low as the rate of output price inflation accelerated to a fresh survey peak; firms continued to share their increasing cost burdens with their clients.

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