Yardeni Research

MORNING BRIEFING
April 12, 2023

Bulls vs Bears

Check out the accompanying chart collection.

Executive Summary: We're still stock market bulls, believing that the bear market ended in October. But now that the Fed's tightening has touched off a financial crisis, we'd defect to the bear camp IF the Fed were to keep on tightening. … While industry analysts have been lowering their earnings sights this year, that's almost moot to stock investors, who are more focused now on next year's better growth prospects. … Also: The current concerns of small business owners are anything but small, including inflation, labor shortages, and a possible credit crunch. … And: The MegaCap-8's upcoming Q1 earnings reports could set the tone for the S&P 500's performance.

Strategy I: Stalemate Between the Bulls & Bears. The stock market seems to be experiencing a stalemate in the trench war between the bulls and the bears. Neither side has gained any ground. Since the S&P 500 first fell to the 4000 level last year on May 9, it's been going nowhere fast, fluctuating in a wide range of 4305 on the upside and 3577 on the downside (*Fig. 1*).

Arguably, the bulls' case has advanced significantly if last year's bear market ended on October 12, as we believe. The S&P 500 is up 14.9% since then through Monday's close. About half of that gain has been logged this year: The S&P 500 is up 7.0% ytd, led by Communication Services (22.1%), Information Technology (19.9), and Consumer Discretionary (12.8) (*Fig. 2*).

Nevertheless, the bears are confident, as they were at the start of this year, that last year's bear market isn't over. Most of them are expecting the S&P 500 to fall below last year's closing low of 3577 on October 12.

At the start of this year, the bears were mostly hard landers, expecting the economy to fall into a recession that would depress both earnings and valuations during the first half of this year. The surprising strength in January's economic indicators during February converted many bears into no-landers even as they remained bearish, figuring that a strong economy would force the Fed to raise interest rates even higher to beat down inflation. The result would be an inevitable recession, but delayed to the second half of the year, with bearish consequences for the stock market, of course. In other words, according to the bears, good economic news is still bad news.

The banking crisis that started in early March convinced the bears that an economy-wide credit crunch is inevitable, and so is a recession—all the more reason to stay bearish, in their opinion.

We've been siding with the bulls since late October, when we concluded that the bear market was over. However, now that something has broken in the financial markets as a result of the Fed's aggressive monetary tightening cycle, we are ready to turn into pessimists on the economic prospects and bears on the stock market outlook IF the Fed doesn't stop raising interest rates, as we wrote in yesterday's *Morning Briefing*.

Strategy II: Earnings Stalemate. The bears are right about S&P 500 operating earnings per share this year. Industry analysts have cut their estimates so much that the consensus has fallen by 4.2% from $229.52 at the start of the year to $219.83 during the April 6 week (*Fig. 3*). They've been lowering their estimates for all four quarters of this year (*Fig. 4*).

The analysts collectively now expect the following y/y growth rates for Q1 (-7.7%), Q2 (-6.6), Q3 (1.4) and Q4 (9.7). They estimate that earnings will be up 0.8% this year and 12.3% next year. The analysts have also been cutting their estimate for 2024's S&P 500 operating earnings per share by 2.6%, from $253.37 at the start of this year to $246.83 during the April 6 week.

So why isn't the stock market going down along with consensus earnings forecasts? As the current year passes, investors are giving greater weight to next year's earnings than to this year's. So they're increasingly looking past 2023 into 2024, when analysts expect that earnings will be higher than this year. The bears haven't said much about next year, but they have opined that their recession scenario now applies to the second half of this year, implying that the economy should be growing again next year.

The time-weighted average of analysts' consensus earnings expectations for this year and next year—i.e., "forward earnings"—was $227 per share during the week of April 6. It's been hovering around this level for the past 11 weeks. That's after falling 5.8% from its record high on June 23, 2022.

While forward earnings has been in a funk since last summer, S&P 500 forward revenues rose to a new record high during the March 30 week (*Fig. 5*). The forward profit margin, which we derive from forward earnings and revenues, peaked last year at a record 13.4%

during the June 9 week and fell to a two-year low of 12.3% during the March 30 week.

US Economy: The View From the Trenches. While the bulls and the bears have been stalemated in their trench war, small business owners are fighting their own trench war against inflation, labor shortages, and a possible credit crunch. Let's have a look at the March survey of small business owners conducted by the National Federation of Independent Business:

(1) *Inflation.* Last month, 24% of small business owners said that inflation is their most important problem (*Fig. 6*). That's down from 37% during July 2022. Only 3% of them said that the availability and cost of credit is their number one problem.

The percent of small business owners either raising or planning to raise their prices fell to 37% and 26% during March, down from their respective peaks of 66% and 54% during March 2022 and November 2021 (*Fig. 7*).

(2) *Labor.* The labor market remains tight. However, fewer small business owners, i.e., 15%, are planning to increase hiring over the next three months. That's down from the record high of 32% during August 2021 (*Fig. 8*).

The percentage of respondents with job openings declined from 47% during February to 43% during March. That's still a very high reading and suggests that the comparable JOLTS series for job openings also remain high in March (*Fig. 9*).

(3) *Credit.* When asked whether "credit was harder to get than last time," 9% responded in the affirmative (on a net basis), up from 5% in February (*Fig. 10*). That's not much, but it is up sharply. Also the percentage saying that they are borrowing at least once a quarter rose to 30% during March, up from a series low of 20% during August and September 2021 (*Fig. 11*).

Review: The MegaCap-8. The MegaCap-8 group of stocks (i.e., Alphabet, Amazon, Apple, Meta, Microsoft, Netflix, Nvidia, and Tesla) is leading the S&P 500 higher in a big way so far in 2023. While the group isn't as cheap as at the start of the year—when its valuation was very depressed—it is decidedly less expensive than during 2020-21, when its forward P/E flirted with 35 (*Fig. 12*). The revived performance is due partly to some of the companies' prospects for a forward earnings turnaround. The same can't be said about the S&P 500 companies generally.

These eight stocks still account for a large part of the S&P 500's market capitalization, revenues, and earnings. Their soon-to-released results for Q1, which should reflect aggressive cost-cutting, could set the tone for the S&P 500's performance. Consider the following:

(1) *Market capitalization.* The MegaCap-8's market cap tumbled 41.5% in 2022 but has rebounded since by 30.0% ytd, to $9.2 trillion as of Friday's close (*Fig. 13*). The S&P 500's market cap is up 6.8% ytd; but excluding the MegaCap-8, it would be up only 1.0% ytd. The MegaCap-8's market-capitalization share of the S&P 500 has recovered too, soaring from 19.4% at the start of the year to 23.7% during the April 7 week (*Fig. 14*).

(2) *Forward revenues and earnings.* Forward revenues and earnings have risen for six of the MegaCap-8 companies (or 75%) so far in 2023, with Apple and Tesla the exceptions. That beats the S&P 500's 61% of companies with forward earnings increases so far in 2023 (*Fig. 15* and *Fig. 16*).

Excluding the MegaCap-8, the S&P 500's forward revenues would be up 1.3% ytd, just slightly higher than the full index's 1.2%. But forward earnings would be down 1.7% ytd without the group, greater than the full index's drop of 1.2%.

Here's how the MegaCap-8's forward revenues and earnings have performed ytd: Alphabet (forward revenues up 1.2%, forward earnings up 3.8%), Amazon (3.1, 8.5), Apple (-1.5, -0.1), Meta (4.3, 33.6), Microsoft (0.8, 1.5), Netflix (5.6, 18.9), Nvidia (8.4, 15.6), and Tesla (-0.4, -16.9).

(3) *Forward profit margin.* Through the March 30 week, the S&P 500's forward profit margin has dropped to 12.3% from 12.6% at the start of the year (*Fig. 17*). The MegaCap-8's forward profit margin behaved the opposite, rising from 18.0% to 18.2%. Among the MegaCap-8 companies, all but Alphabet and Tesla have seen their forward profit margin rise ytd: Alphabet (down from 23.0% to 22.9%), Amazon (3.0 to 3.1), Apple (25.2 to 25.6), Meta (21.1 to 22.6), Microsoft (34.6 to 34.8), Netflix (14.1 to 15.7), Nvidia (36.7 to 38.7), Tesla (15.9 to 13.6) (*Fig. 18*).

(4) *Q1 revenue and earnings outlook.* There will still be pain reflected in Q1's y/y comparisons reported by the MegaCap-8 but less so than during recent past quarters. This could have an impact on overall Q1 results for the S&P 500: Analysts expect the group to account for 5.8% of the S&P 500's Q1 revenues and 13.7% of its Q1 earnings.

Collectively, the MegaCap-8's Q1 revenues are forecasted to rise 1.5% y/y, but earnings are expected to fall 13.7% y/y. Those are considerably poorer than the y/y changes expected for the S&P 500 generally: revenues rising 4.0% and earnings dropping 7.7%.

Calendars

US: Wed: Headline & Core CPI 0.3%m/n/5.2%y/y & 0.4%m/m/5.6%y/y; Real Earnings -0.2%; MBA Mortgage Applications; Federal Budget Balance -$257.0b; Crude Oil Inventories & Gasoline Production; FOMC Minutes; IMF Meetings. **Thurs:** Headline & Core PPI 0.1%m/m/3.1%y/y & 0.3%m/m/3.4%y/y; Initial & Continuous Jobless Claims 231k/253.2; OPEC Monthly Report; Natural Gas Storage; IMF Meetings. (Bloomberg estimates)

Global: Wed: UK RICS House Price Balance -48%; Australia Employment Change 20k; Australia Unemployment & Participation Rates 3.6%/66.5%; China Trade Balance ¥82.0b; BOC Rate Decision 4.50%; De Guindos; Baily; Bullock. **Thurs:** Eurozone Industrial Production 1.0%m/m/1.7%y/y; Germany CPI 0.8%m/m/7.4%y/y; Italy Industrial Production 0.5%m/m/2.9%y/y; UK GDP 0.1%m/m & 0.0%3m/3m; UK NIESR Monthly GDP Tracker 0.1%; UK Headline & Manufacturing Industrial Production 0.2%m/m/-3,7%y/y & 0.2%m/m/-4.6%y/y; %UK Trade Balance -£17.0b; UK BOE Credit Conditions Survey; Nagel; Buch; Pill; Macklem. (Bloomberg estimates)

US Economic Indicators

NFIB Small Business Optimism Index (*link*): "Small business owners are cynical about future economic conditions," said NFIB Chief Economist Bill Dunkelberg. "Hiring plans fell to their lowest level since May 2020, but strong consumer spending has kept Main Street alive and supported strong labor demand." March's *Small Business Optimism Index* (SBOI) continued to bounce around recent lows, dipping 0.8 point to 90.1 after climbing the first two months of the year to 90.9, after falling 2.1 points in December to 89.8. March's SBOI was below the 49-year average of 98.0 for the 15th consecutive month. The last time the index was at or above the average was December 2021 (98.9). In March, three of the 10 components of the SBOI increased while six decreased; expect the economy to improve was unchanged at a net -47%. Earnings trends (+5ppts to a net -18%), current inventory (+5 to 1), and plans to increase inventories (+3 to -4) contributed positively to the SBOI, while sales expectations (-6 to -15), current jobs openings (-4 to 43), and now is a good time to expand (-4 to 2) were the biggest drags on the SBOI, though the job opening percentage remained historically high. Smaller declines were posted for expected credit conditions (-3 to -9), hirings (-2 to 15), and capital outlay plans (-1 to 20). *Inflation* continued to be small business owners' single biggest problem in March, for 24% of respondents, though that's down 13ppts from last July's peak of 37% (which was the highest since Q4-1979)—and the lowest in 14 months. Meanwhile, *quality of labor* remained business owners' second biggest problem in March, at 23%, averaging 22.6% the past five quarters. It was at a record high of 29% during November 2021. Taxes (15%) and cost of labor (11) round out the top five biggest problems, though taxes pulled ahead of labor costs last month. The net percentage of owners *raising selling prices* continued to ease, sinking to a 23-month low of 37% in March from a near-record-high 66% last March, while the net percentage of owners *planning to increase selling prices* ticked up to 26% after falling from 29% to 25% in February, not far from December's 24%—which was its lowest percentage since December 2020; it was at a near record high of 52% last March. A net 42% of owners reported *raising compensation* last month, down from 46% the first two months of this year and near its recent low of 40% last November; it was at a record high 50% at the start of 2022. A net 22% of owners *plans to increase compensation* in the next three months—back down at January's a 20-month low, and 10ppts below October 2022's 32%—which matched the record high posted the final two months of 2021.

Global Economic Indicators

Eurozone Retail Sales (*link*): High inflation and tight credit conditions continue to depress Eurozone retail sales, which remain on a volatile downtrend, dropping 4.4% from June 2021's record high. Sales in February contracted 0.8% after a 0.8% gain and a 1.5% loss the prior two months. A 1.8% drop in sales of *automotive fuels* led February's decline, which followed a 0.9% drop in January. Spending on *food, drinks & tobacco* sank for the fourth time in five months, by 0.6% m/m and 2.4% over the period, rising only two months during all of last year, while sales of *non-food products excluding fuel* continued its up-and-down pattern, falling 0.7% in February, following a 0.9% increase and a 2.3% decrease the previous two months. Over the 12 months through February, only automotive fuels (1.1% y/y) was in the plus column—foods drinks & tobacco (-4.9) and *non-food products ex fuel* (-1.8) were in the red. February data are available for all four of the *Eurozone's largest economies*, and show sales in *Germany* contracted for the third time in five months, down 1.3% m/m and 4.6% over the period to its lowest level in two years, while *France* posted its fourth decline in five months, by 1.5% in February and 3.2% over the five-month period to its lowest level since May 2021. Meanwhile, sales in *Spain* fell for the first time in seven months, ticking down 0.3% in February after a six-month gain of 4.9%, while Italy recorded a 0.4% downtick in February, after a 0.7% gain and a 1.4% loss. *Compared to a year ago*, sales in Spain (4.7% y/y) were up, but sales in Germany (-7.0), Italy (-2.8), and France (-2.3) were down.

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