MORNING BRIEFING
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Covid Again? Upbeat NERI

Check out the accompanying chart collection.

Executive Summary: China bracing for another Covid wave but will rely on vaccines rather than lockdowns. … Latest earnings was better than expected, but S&P 500 earnings was still down 3.0% y/y, which is better than the -7.0% consensus expectation. Q2 should be down again modestly before comps turn positive again. … Joe reviews the latest NERI readings, which seem to be turning more optimistic.

Covid: Another Wave in China. Yesterday, we observed that China's economy isn't performing as well as the government would like to see. China's imports have been flat since the second half of 2021. PPI prices are falling as is the price of copper, which is a very sensitive indicator of China's economic activity. So, the Peoples Bank of China lowered its bank reserve requirement three times since 2022. Bank loans soared by a record $3.4 trillion over the past 12 months.

What's the matter with China? Here are a few simple explanations: China's rapidly aging demographic profile is inherently deflationary. The country's property bubble has burst. The government's aggressive moves to regulate and supervise business activity is killing the country's entrepreneurial spirit. The Chinese regime's instigation of a Cold War with the West (as well as with its Asian neighbors) and massive military spending may be weighing on its economy.

And now, China is bracing for another wave of Covid. On May 22, Bloomberg *reported*: "China is likely to see its Covid-19 wave peaking at about 65 million infections a week toward the end of June, according to a senior health adviser, while authorities rush to bolster their vaccine arsenal to target the latest omicron variants." Apparently, immunity among the country's 1.4 billion residents is already waning just six months after Beijing ended its lockdowns in early December. The government is preparing to roll out XBB vaccines, but China's Covid vaccines have tended to be less effective than mRNA versions available overseas. The government has favored homegrown vaccines.

Strategy I: Waiting for S&P Data on Q1 Earnings. The Q1 earnings season is over. Joe and I are waiting for Standard & Poor's to compile the final tally. Joe has been tracking the

Q1 earnings reports of the S&P 500. He observes that with 471 results through Monday's close, revenues are ahead of the consensus forecast by 2.3%, and earnings have exceeded estimates by 7.1%.

Of the 471 Q1 reporters, 74% have reported a positive revenues surprise, while 77% have reported an earnings beat. Those are big improvements from their Q4-2022 readings of 68% for both revenues and earnings.

The collective revenue gain for the 471 reporters is 4.2% y/y, and earnings are down 3.0% y/y following a 1.9% y/y decline in Q4-2022. Another modest decline is likely in Q2 before the comparisons turn positive during H2.

Strategy II: Analysts Asking, 'So Where's This Recession?' Yesterday, Refinitiv released its May snapshot of industry analysts' consensus estimate revision activity over the past month. While the firm provides the raw data for all its polled measures, we focus primarily on the revenues and earnings forecasts. We use these data to get a handle on whether analysts generally have been growing more pessimistic, optimistic, or neither about the prospects for the companies they follow.

In our *Stock Market Indicators: Net Revenue & Earnings Revisions By Sectors* report, we index the analysts' revisions activity by taking the number of forward earnings estimates that were revised up less the number revised down, expressed as a percentage of the total number of forward earnings estimate revisions. We look at this activity over the past three months so that it better represents what's happened over an entire quarterly reporting cycle. This makes the series less volatile (and less misleading) than a weekly or monthly series, and the trends become more apparent.

May's reading comes at the tail end of the quarterly earnings reporting cycle, when analysts typically adjust their forecasts the most. It shows a clear break in the long period of mostly downward revisions. Perhaps analysts as a group are beginning to realize that there will not be a deep recession or a recession at all. Perhaps like us, they now expect just a mid-cycle slowdown, with negative y/y quarterly growth comparisons due simply to the strong year-earlier results, reflecting robust pricing power.

Below, we highlight some notable takeaways from these data series:

(1) S&P 500 NERI back to neutral. The S&P 500's Net Earnings Revisions Index (NERI), which measures the revisions activity for earnings forecasts, improved considerably m/m in

May (*Fig. 1*). It rose to 0.0% (indicating equal numbers of raised and lowered estimates over the past three months) from -6.7% in April. May's release was: 1) the first non-negative reading since last June, 2) up from a 30-month low of -15.6% in December, 3) the biggest jump in 24 months, and 4) above the average reading of -2.2% seen since March 1985 when we first calculated the series.

(2) S&P 500 NRRI shows revenues revisions still positive and rising. The S&P 500's Net Earnings Revenues Revisions Index (NRRI), which measures the revisions activity in analysts' revenue forecasts, was positive for a fifth straight month, rising to a 12-month high of 5.0% from 1.4% in April (*Fig. 2*). That's above the average reading of -0.3% since the first calculation of that data in March 2004.

(3) Nearly half of the S&P 500's sectors now have positive NERI. Five sectors had positive NERI in May, up from zero during March and April (*Fig. 3*). All 11 sectors improved m/m. That was the broadest improvement among the sectors since July through September 2020, when analysts were scrambling to raise forecasts as the US economy reopened.

Seven of the 11 sectors hit their highest NERI readings in at least 10 months. Among them, Health Care and Consumer Discretionary turned positive for the first time in 14 months. Communication Services improved but remained negative for a 19th month. Energy and Financials both remain challenged.

Here's how NERI ranked for the 11 sectors in May: Industrials (9.3%, a 19-month high), Consumer Staples (4.5, 19-month high), Consumer Discretionary (4.3, 15-month high), Health Care (3.1, 16-month high), Information Technology (0.7, 11-month high), S&P 500 (0.0, 11-month high), Communication Services (-1.9, 17-month high), Materials (-2.8, 10-month high), Utilities (-3.7, 7-month high), Real Estate (-4.3, 8-month high), Financials (-10.1, 7-month high), and Energy (-17.2, 2-month high).

(4) NRRI positive for six sectors now. NRRI's m/m performance was a tad weaker than NERI's by one measure: Nine sectors had NRRI readings improve m/m, versus all 11 with improving NERI (*Fig. 4*).

However, six sectors still hit their highest NRRI readings in at least 11 months. NRRI weakened for only two sectors m/m, Consumer Staples and Materials.

Here's how their NRRI ranked in May: Utilities (22.4%, a record high!), Consumer Staples (13.5, 5-month low), Consumer Discretionary (13.1, 19-month high), Health Care (12.7, 19-

month high), Industrials (11.4, 19-month high), Real Estate (7.5, 7-month high), S&P 500 (5.0, 12-month high), Information Technology (-1.3, 11-month high), Financials (-2.0, 2-month high), Materials (-5.1, 2-month low), Communication Services (-10.9, 13-month high), and Energy (-21.3, 3-month high).

Calendars

US: Thurs: GDP & GDP Price Index 1.1%/4.0%; PCE Headline & Core Prices 4.2%/4.9%; Real Consumer Spending 3.7%; Corporate Profits -0.9%; Initial & Continuous Jobless Claims 250k/1.80m; Kansas City Manufacturing Index -5; Chicago Fed Natural Activity Index -0.02; Pending Home Sales 0.5%; Natural Gas Storage; Collins. **Fri:** Headline & Core PCED 0.4%m/m/3.9%y/y & 0.3%m/m/4.6%y/y; Personal Income & Spending 0.4%/0.4%; Consumer Sentiment Headline, Current Conditions, and Expectations 57.9/64.5/53.4; University of Michigan One- and Five-Year Inflation Expectations 4.5%/3.2%; Headline & Core Durable Goods Orders -1.0%/0.0%; Nondefense Capital Goods Orders Ex Aircraft -0.5%; Advance Goods Trade Balance -$85.7b; Wholesale & Retail Inventories; Baker-Hughes Rig Count. (Bloomberg estimates)

Global: Thurs: Germany GDP -0.1%q/q/0.2%y/y; Germany Gfk Consumer Confidence -24.0; France Business Survey 101; Australia Retail Sales 0.3%; De Guindos; Nagel; Haskel. **Fri:** France Consumer Confidence 84**;** Italy Consumer & Business Confidence 105.5/102.5; UK Headline & Core Retail Sales 0.4%m/m/-2.8%y/y & 0.3%m/m/-0,8%y/y; Enria; Lane; Mauderer. (Bloomberg estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The *Bull-Bear Ratio* rose this week to 1.95, after falling the prior two weeks from 1.94 to 1.83; it was at 2.11 five weeks ago—which was the highest reading since the January 4 week last year. *Bullish* sentiment rose for the second week to 46.5%, after falling the prior three weeks from 50.7% (the highest since November 2021) to 44.6%. Bulls outnumbered bears for the 27th consecutive week. *Bearish* sentiment edged down to 23.9% this week after climbing the prior two weeks from 23.6% (which was the fewest bears since early January 2022) to 24.7%. The *correction count* moved down for the second week to 29.6% after moving higher the prior three weeks from 25.3% to 31.3%—remaining well below its late September 2022 peak of 40.3%. Turning to the *AAII*

Sentiment Survey (as of May 18), bullish and bearish sentiment fell during the week, the former to a seven-week low, while neutral sentiment increased. The *percentage expecting stock prices to rise* over the next six months fell 6.5ppst to 22.9% during the latest week after rising from 24.1% to 29.4% the prior week—with optimism unusually low 51 of the past 72 weeks. The *percentage expecting stocks to fall* over the next six months fell for the second week to 39.7% after climbing the prior three weeks by 10.4ppts (to 44.9% from 34.5%). Pessimism was back within its historical range after two weeks at unusually high levels. It remains above its historical average of 31.0% 73 of the past 78 weeks. The *percentage expecting stock prices will stay essentially unchanged* over the next six months climbed to 37.4% after falling the prior four months from 39.5% to 29.4%—putting neutral sentiment above its historical average of 31.5% for the first time in three weeks.

S&P 500 Sectors & Industries Forward Profit Margin Since Peak (*link*): Since the S&P 500's forward profit margin peaked at a record-high 13.4% during the June 9, 2022 week, it has fallen 8.0% to 12.3% through the May 18, 2023 week. Ten of the 11 sectors' margins are down since the peak, but the S&P 500's drop has been paced by just three of the 11 sectors. Here's the sector performance since the June 9, 2022 forward profit margin peak: Industrials (up 1.5% to 10.5%), Financials (down 2.9% to 18.5%), Consumer Discretionary (down 2.9% to 7.5%), Energy (down 4.6% to 11.4%), Real Estate (down 5.3% to 17.0%), Communication Services (down 5.6% to 15.2%), Utilities (down 7.1% to 12.9%), Information Technology (down 7.3% to 23.6%), S&P 500 (down 8.0% to 12.4%), Consumer Staples (down 8.2% to 6.7%), Health Care (down 13.2% to 9.5%), and Materials (down 18.7% to 11.0%). These are the best performing industries since the June 9, 2022 peak: Casinos & Gaming (up 162.2% to 5.9%), Human Resource & Employment Services (up 103.5% to 18.7%), Wireless Telecommunication Services (up 84.7% to 12.5%), Oil & Gas Refining & Marketing (up 47.2% to 5.0%), Passenger Airlines (up 43.5% to 5.8%), Hotels, Resorts & Cruise Lines (up 25.9% to 12.4%), and Oil & Gas Equipment & Services (up 20.1% to 11.0%). The worst performing industries since the June 9, 2022 peak: Commodity Chemicals (down 37.4% to 6.4%), Housewares & Specialties (down 36.4% to 5.3%), Broadcasting (down 35.6% to 3.6%), Copper (down 35.6% to 12.4%), Home Furnishings (down 34.5% to 5.8%), Paper & Plastic Packaging Products & Materials (down 30.4% to 6.1%), and Fertilizers & Agricultural Chemicals (down 29.6% to 14.6%).

Global Economic Indicators

Germany Ifo Business Climate Index (*link*): Germany business confidence suffered a setback in May, falling for the first time in seven months as "German companies are skeptical about the upcoming summer," noted Clemens Fuest, Ifo's president. German business *confidence* fell to 91.7 in May after climbing the prior six months, from 85.1 last October to 93.4 this April—which was the highest since February 2022. *Expectations* took the biggest hit this month, dropping to 88.6, from a seven-month upswing of 15.2 points—from 76.5 last September to 91.7 in April. Meanwhile, *current conditions* remained around recent lows, slipping less than a point the past two months—to 94.8 this month, up from its recent low of 93.3 last November—averaging 94.7 the past six months. The *manufacturing* sector saw its business climate index deteriorate this month, sinking 6.6 points to -0.3, after a 0.2-point dip in April—which followed a five-month surge of 20.8 points (to 6.5 from -14.3). The expectations component tumbled 11.5 points this month to -13.8, after climbing the prior six months by 35.9 points (to -2.3 from -38.2), while current conditions remain in a flat trend around recent lows, averaging 16.0 the first five months of this year—ranging from 14.1 to 19.1. The *service sector* saw its business climate index (to 6.8 from 6.9) hold steady, as companies remain optimistic about current conditions (24.3 from 22.1) and pessimistic about future conditions (-9.5 from -7.2), with the former at a nine-month high and the latter at a three-month low. Sentiment in the *trade sector* saw a major decline, sinking 8.4 points (to -19.1 from -10.7) this month as current conditions (-2.8 from 4.3) dropped below zero for the first time in six months, while expectations (-34.1 from -24.7) deteriorated further. The *construction sector* remained entrenched in negative territory, falling from -16.6 to -18.2 this month, as current conditions (-3.0 from 0.9) fell below zero for the first time since December 2015 and expectations (-32.4 from -32.5) were little changed deep in negative territory, though was less negative than its recent low of -47.2 last October.

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