MORNING BRIEFING
June 29, 2023

Brokers, Earnings & Green Steel

Check out the accompanying chart collection.

Executive Summary: Is capital markets activity finally picking up? In Jefferies Financial's recent earnings call, Jackie found reasons to suspect so, including a 16% q/q surge in advisory and underwriting business. Moreover, the IPO market appears to be reviving, and analysts see good earnings growth next year for the S&P 500 Investment Banking & Brokerage industry. … Also: A look at which S&P 500 sectors and industries analysts expect to grow earnings the most and least this year and next. Notably, the Consumer Discretionary and Communication Services sectors top the list for both years. … And: Companies stepping up to the challenge and opportunities of producing green steel.

Financials: Could Better Days Lie Ahead? Jefferies Financial Group's latest quarterly earnings report, which came out after the stock market closed on Tuesday, was awful, but it did contain a glimmer or two of hope that the worst may have passed for the capital markets and investment banks. The markets have certainly been friendlier of late. The S&P 500 has risen 14.0% ytd through Tuesday's close, the VIX has fallen to 13.4, and the IPO market has thawed, with four deals expected to raise more than $100 million each this week. And while interest rates are higher than they were a year ago, they appear to have stabilized and stopped their upward trajectory.

Let's take a look at Jefferies' fiscal Q2 (ended May 31) earnings, with an eye toward what they might mean for the larger investment banks that will report results in the days and weeks ahead:

(1) *Looking hard for sunshine.* Jefferies reported a 22.5% y/y drop in revenue to $1.0 billion for its fiscal Q2. The bottom line didn't look much better, with net earnings attributable to Jefferies common shareholders tumbling to $12.4 million from nearly ten times that—or $114.0 million—in the year-ago quarter. Results were hurt by $72 million of pretax losses related to a merchant banking investment in OpNet.

Look a little deeper, and there were some signs that capital markets activity has started to pick up after being almost completely shut down earlier in the year. Jefferies' revenue from advisory and equity and debt underwriting was up 15.9% q/q and up 3.9% y/y in its fiscal Q2. Equity and fixed-income capital markets revenue presented a more mixed picture, falling 15.1% q/q but rising 30.4% y/y.

“The month of June has brought green shoots in our investment banking and capital markets business and we are growing increasingly optimistic about the return to a more normal environment. These developments include a more forward-looking attitude from our investor base and a stronger willingness from our corporate clients to engage in capital formation and other major strategic initiatives,” stated CEO Richard Handler and President Brian Friedman in the earnings *press release*.

(2) *IPO market shows signs of life.* After being abnormally silent for more than a year, the IPO market has started to return to life. This first signs arrived when fast-food chain Cava Group’s IPO almost doubled when it came to market on June 15, even after being priced well above the initial price range.

The market’s momentum continued this week with six IPOs slated to price. Four of the planned offerings are attempting to raise north of $100 million. They are Vesta Real Estate, which owns and operates industrial real estate properties in Mexico; Kodiak Gas Services, a natural gas compression service; Savers Value Village, a for-profit thrift store; and Fidelis Insurance Holdings, a specialty insurance and property reinsurance provider, according to Renaissance Capital. In Q2, 23 IPOs came to market, the same as in Q1, but the $6.7 billion raised in Q2 was the highest in six quarters, the firm *reports*. While some of the small deals that sold stock didn’t perform well, the large deals that raised more than $100 million rose 25% from their IPO price.

The Renaissance analysts are optimistic about upcoming months: “Looking ahead, we believe the summer IPO market is poised to capitalize on several positive developments from the past quarter: the pause in rate hikes, the pickup in larger deals at quarter end, and improving returns, with the IPO Index up 26% year-to-date. The backlog appears brimming with solid IPO candidates, and we expect a steady rise in listings in the second half.”

(3) *Banks & brokers getting lean.* After almost a year and a half of slow investment banking activity and tough stock markets, many investment banks have announced layoffs. Goldman Sachs Group reportedly plans to lay off about 125 managing directors around the world, a June 26 Bloomberg *article* reported. These cuts come after three other rounds of layoffs over the past year. Smaller cuts have been reported at JPMorgan Chase and Citigroup as well.

UBS Group, which acquired Credit Suisse Group in an emergency takeover, plans to cut more than half of the acquired firm's 45,000-person workforce beginning in July. "Bankers, traders and support staff in Credit Suisse's investment bank in London, New York, and in some parts of Asia are expected to bear the brunt of the cuts, with almost all activities at risk," according to a June 28 Bloomberg *article* citing "people familiar with the matter."

Jefferies has used these dislocations to add to its workforce, hiring 21 new managing directors since the beginning of fiscal 2023 in areas that are incremental to its existing coverage universe. The firm plans to continue recruiting additional talent as it plays "prudent offense."

(4) *Analysts see earnings improving.* The S&P 500 Investment Banking & Brokerage stock price index—which includes Goldman Sachs, Morgan Stanley, Raymond James Financial, and Charles Schwab—has fallen 14.6% ytd through Tuesday's close, a performance that beats that of only one other industry in the S&P 500 Financials sector: the Regional Banks industry, with a 38.0% ytd decline (*Fig. 1*).

The Investment Banking & Brokerage industry's revenue and earnings declined during the bear market of 2022 and were basically flat this year, but 2024 may be the year results turn around. Revenue was down 10.5% in 2022, and it's expected to rise only 1.1% in 2023 before increasing 7.6% in 2024 (*Fig. 2*). Earnings follow a similar pattern: They fell 30.7% in 2022, and they're expected to rise only 1.5% this year before jumping 19.4% in 2024 (*Fig. 3*). Analysts' net earnings revisions have been decidedly negative for 15 months and were -34.8% in June, -36.8% in May, and -38.5% in April (*Fig. 4*).

The industry's forward P/E isn't down in the single digits as is sometimes seen during a financial crisis. But at 11.4, it's lower than the 14.6 it hit in January 2021 (*Fig. 5*). If the capital markets continue to awake from their slumber, the S&P Investment Banking & Brokerage industry may finally emerge from the doghouse.

Strategy: Peeking into 2024. In addition to planning Fourth of July barbeques, the year's halfway point is a great time to look at analysts' forecasts for S&P 500 sectors' and industries' earnings growth in the coming year. With the start of 2024 just six months away, investors begin to focus on what they hope will happen after the New Year's ball drops. Let's take a look at where 2024 earnings estimates stand:

(1) *Consumer Discretionary on top again.* The S&P 500 Consumer Discretionary and Communication Services sectors are expected to have the strongest earnings growth among sectors during 2024 for the second year in a row. And for both this year and next,

Energy and Materials will have among the slowest earnings growth.

Here's the performance derby for the 2024 earnings expected for the S&P 500 and its 11 sectors: Consumer Discretionary (18.7%), Communication Services (17.9), Information Technology (15.6), Industrials (13.4), S&P 500 (11.5), Financials (9.4), Consumer Staples (9.2), Health Care (9.1), Real Estate (8.9), Utilities (8.6), Materials (5.2), and Energy (0.4) (*Table 1*).

Compare that to the S&P 500 sectors that are expected to have the best and worst earnings in 2023: Consumer Discretionary (24.4%), Communication Services (17.0), Industrials (14.6), Financials (10.6), Utilities (6.0), Consumer Staples (1.4), S&P 500 (0.2), Information Technology (-2.6), Health Care (-9.4), Materials (-17.0), Real Estate (-17.0), and Energy (-25.4) (*Table 2*).

(2) *Industries in travel and the Industrials sector top the list.* Analysts seem to expect consumers to continue their wanderlust in 2024. Among travel-related industries, those with the fastest projected earnings growth in 2024 are: Casinos & Gaming (74.4%), Hotels (32.3), and Passenger Airlines (20.6). In addition to Passenger Airlines, two large industries that hail from the S&P 500 Industrials sector also top the list: Aerospace & Defense (26.8) and Industrial Conglomerates (25.0).

Here are the industries that are expected to have the top 10 fastest earnings growth next year: Publishing (87.3%), Casinos & Gaming (74.4), Movies & Entertainment (59.2), Personal Care Products (57.5), Property & Casualty Insurance (35.5), Wireless Telecommunication Services (34.9), Semiconductors (34.8), Hotels (32.3), Commodity Chemicals (30.5), and Reinsurance (30.2).

(3) *A look at the downtrodden, too.* The S&P 500 industries with the slowest earnings growth—or outright declines in earnings—include a number of industries in the Financials, Materials, and Energy sectors. Here are the bottom 10 industries: Steel (-34.3%), Oil & Gas Refining & Marketing (-29.8), Semiconductor Materials & Equipment (-7.4), Agricultural Products & Services (-3.9), Construction Machinery & Heavy Transportation Equipment (-3.3), Fertilizers & Agricultural Chemicals (-2.2), Integrated Oil & Gas (-2.1), Regional Banks (-1.8), Diversified Banks (-1.1), and Food Retail (0.5).

Disruptive Technologies: Making Green Steel. The global steel industry contributes between 7% and 9% of the world's carbon dioxide emissions, which makes it a prime candidate for greenification; but greenifying this industry is difficult. Steel making requires vast amounts of energy, typically supplied by burning coal. Figuring out how to eliminate coal from the process—and the CO_2 emitted when it burns—is a challenge that many companies, small and large, have taken on. Here are some of the leading candidates:

(1) *Harnessing hydrogen.* H2 Green Steel aims to replace coal with clean-burning hydrogen. But to do so, the Swedish company will have to produce a ton of hydrogen. To that end, it's building one of the world's largest electrolysis plants, in Boden, Sweden, a company *press release* states. It will use hydropower and wind power generated nearby. The hydrogen produced will be used onsite in a mill that produces green steel using a direct reduction process, which reduces iron ore to sponge iron. Completion of the green steel plant is expected in 2025, with deliveries targeted for 2027.

Scania, a truck building company; Mercedes Benz; and Marcegaglia, an Italian steel company, are investors in H2 and have entered contracts to buy green steel produced by the company. Cargill Metals, which is not an investor in H2, has also agreed to buy green steel. H2 and Swedish shipping company Gotland are exploring the possibility of building a plant to generate hydrogen to power two new ferries that Gotland is developing; they'll be powered both by hydrogen and other carbon-free fuels.

H2 hopes to produce five million tonnes of green steel a year by 2030, and it's in talks to build additional green steel plants in Spain and Brazil, a February 17 BBC *article* reported. H2 faces competition on its home turf from Hybrit, another Swedish steel company that plans to open a carbon-free plant in Sweden by 2026.

And in Europe, the BBC reported, GravitHy plans to open a hydrogen-based plant in France in 2027, Thyssenkrupp aims to introduce carbon-neutral production at all its plants by 2045, and ArcelorMittal and the Spanish government are investing in green steel projects in northern Spain.

(2) *US green steel.* Boston Metal, a company spun out of the Massachusetts Institute of Technology, has developed a new way of making steel. The company counts ArcelorMittal; Breakthrough Energy Ventures, the fund founded by Bill Gates; and Microsoft's Climate Innovation Fund as investors.

Instead of combining iron ore or iron oxide with coal in a blast furnace, the company passes electricity through iron oxide mixed with other chemical compounds to make iron and oxygen, a January 27 CNBC *article* reported. The catch: Making one million tons of steel per year requires 500 megawatts of electricity, or enough to power half a midsized city.

Boston Metal is hoping that by the time its plants are built, green electricity will be readily available.

The company has a pilot facility in Woburn, Massachusetts, and plans to add a demonstration steel plant next year and commercial-sized plant in 2026. In the future, it intends to license the technology to steel producers and not enter the production business directly.

(3) *Watching ArcelorMittal.* The biggest player in the steel business, ArcelorMittal, is an investor in Boston Metal, but it's also exploring a number of avenues to make its own steel production greener. In some plants, it's replacing coal with existing biomass from agricultural waste or waste plastic. These waste products naturally emit CO_2 as they decompose, so using them in a steel mill makes for a carbon-neutral process. The company has built a plant that converts waste wood into renewable energy through a process called "torrefaction." The plant, which is being built in Belgium next to an existing steel plant, is expected to reduce the steel plant's CO_2 emissions by 225,000 tonnes per year, according to Arcelor's *website*.

ArcelorMittal notes that there isn't currently the infrastructure available to make large enough quantities of green hydrogen. Until there is, the company is using blue hydrogen (hydrogen extracted from natural gas) and carbon capture and storage technologies. At the company's steel plant in Hamburg, Germany, hydrogen is generated from the capture of waste gasses. When green hydrogen is abundant enough and economical enough, ArcelorMittal hopes to make the switch.

Calendars

US: Thurs: GDP & GPD Price Index 1.4%/4.2%; PCED Headline & Core PCED 4.2%/5.0%q/q; Corporate Profit -6.8%; Pending Home Sales 0.2%; Initial & Continuous Jobless Claims 266k/1.765m; Natural Gas Storage; Powell; Bostic. **Fri:** Personal Income & Spending 0.3%/0.2%; Headline & Core PCED 0.5%m/m/4.6%y/y & 0.4%m/m/4.7%y/y; University of Michigan Consumer Sentiment Total, Current Conditions, and Expectations 63.0/68.0/61.3; University of Michigan Inflation Expectations 3.3%; Chicago PMI 44.0; Baker-Hughes Rig Count; Powell. (Bloomberg estimates)

Global: Thurs: Eurozone Business & Consumer Survey 96.0; Germany CPI 0.3%m/m/6.7%y/y; Spain CPI 0.4%m/m/1.5%y/y; Japan Household Confidence 36.2; Japan

Unemployment Rate 2.6%; Japan Industrial Production -1.0%; China M-PMI & NM-PMI 49.0/53.7; ECB Economic Bulletin; EU Leaders Summit; Mauderer; Balz; Tenreyro. **Fri:** Eurozone Headline & Core CPI 0.0%m/m/5.6%y/y & 0.7%m/m/5.5%y/y; Eurozone Unemployment Rate 6.5%; Germany Import Prices -1.4%m/m/-9.2%y/y; Germany Retail Sales 0.0%m/m/-6.7%y/y; Germany Unemployment Rate 5.6%; Italy Unemployment 7.9%; France Consumer Spending 0.6%, France CPI 0.2%m/m/5.3%y/y; UK GPD 0.1%q/q/0.2%y/y; UK Nationwide HPI -0.3%m/m/-3.3%y/y; EU Leaders Summit. (Bloomberg estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The *Bull-Bear Ratio* ticked down to 2.69 this week, after rising the prior five weeks from 1.83 to 2.72—which was the highest since mid-August 2021. *Bullish* sentiment dipped to 50.0% this week, after climbing the prior six weeks by 9.7ppts (to 54.3 from 44.6) to its highest percentage since November 2021. *Bearish* sentiment fell this week for the sixth straight week, from 24.7% to 18.6% over the period, the fewest bears since early January 2022. The *correction* count increased to 31.4% this week, after falling the prior six weeks by 5.4ppts (to 25.7 from 31.1) to a nine-week low. Turning to the *AAII Sentiment Survey* (as of June 22), optimism decreased, though remains above average for the third straight week, while bearish sentiment moved higher after sinking to its lowest level since July 2021 the prior week. Neutral sentiment moved lower. The *percentage expecting stock prices to rise* over the next six months fell 2.3ppts to 42.9%, after climbing the prior four weeks by 22.3ppts (to 45.2% from 22.9%). Optimism was above its historical average of 37.5% for the third straight week. The *percentage expecting stocks to fall* over the next six months climbed 5.1ppts to 27.8% during the latest week, after falling the prior three weeks by 17.0ppts (to 22.7% from 39.7%) to its lowest percentage since July 1, 2021 (24.0%). Pessimism has been below 30.0% for the third consecutive week—the longest string that pessimism has been below 30.0% since a five-week streak in October and November 2021. The *percentage expecting stock prices will stay essentially unchanged* over the next six months slipped 2.7ppts to a six-week low of 29.4%, with neutral sentiment remaining below its historical average of 31.5%.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin edged down 0.1pt w/w to 12.4% during the June 22 week. That's up from a 24-month low of 12.3% during the March 30 week, but down 1.0pt from its record high of 13.4% achieved intermittently in 2022 from March to June. It's now 2.1pts above its seven-year low of 10.3% during April 2020. Forward revenues rose 0.2% w/w to a new record high. Forward earnings dropped 0.3% w/w, but is only 3.5% below its record high during the June 16, 2022 week. 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 forward revenues growth was steady w/w at a seven-month high of 3.4% and is now up 1.1pts from its 33-month low of 2.3% during the February 23 week. That's down from a record high of 9.6% growth at the end of May 2021 and compares to 0.2% forward revenues growth during April 2020, which was the lowest reading since June 2009. Forward earnings growth ticked up 0.1pt w/w to an eight-month high of 6.9% and is now 3.4pts above its 31-month low of 3.5% in mid-February. 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. Analysts expect revenues to rise 1.9% in 2023 (up 0.1ppt w/w) and 4.6% in 2024 (unchanged w/w) compared to a revenues gain of 12.3% in 2022. They expect earnings growth of 0.2% in 2023 (unchanged w/w) and an 11.5% rise in 2024 (up 0.1ppt w/w) compared to an earnings gain of 7.1% in 2022. Analysts expect the profit margin to drop 0.1ppt y/y to 12.0% in 2023 (unchanged w/w), compared to 12.1% in 2022, and to rise 0.7ppt y/y to 12.7% in 2024 (down 0.1ppt w/w). The S&P 500's weekly reading of its forward P/E was steady w/w at a 14-month high of 19.0. That's up from a 30-month low of 15.3 in mid-October. It 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 was unchanged w/w at a 10-month high of 2.36. That's up from a 31-month low of 1.98 in mid-October and down from a four-month high of 2.38 in mid-August; it 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*): Looking at the 11 S&P 500 sectors, the June 15 week saw consensus forward revenues rise for seven sectors and forward earnings rise for only one sector. The forward profit margin rose w/w for three sectors. Two sectors have forward revenues at a record high this week: Communication Services and Health Care. Among the remaining nine sectors, only Energy and Financials have forward revenues more than 5.0% below their post-pandemic highs. Industrials is the only sector with forward earnings at a record high this week, but these two remain less than 0.3% below their recent records: Consumer Staples and Utilities. Among the remaining nine sectors, just three have forward earnings down more than 10.0% from their post-pandemic highs: Energy, Financials, and Materials. Since mid-August, all but the Industrials sector have seen forward profit margins retreat from their record highs, but eight of the 11 sectors are showing early signs of recovering from their lows in early 2023. Industrials' forward profit margin is at a record high again this week, but Consumer Staples and Health Care are at record lows. Those of Communication Services, Consumer

Discretionary, Financials, Real Estate, and Tech remain close to their post-pandemic highs. Energy and Industrials were the only two sectors to have their profit margins improve y/y for full-year 2022, and these five sectors are expected to see them improve y/y in 2023: Communication Services, Consumer Discretionary, Financials, Industrials, and Utilities. Here's how the sectors rank based on their current forward profit margin forecasts along with their record highs: Information Technology (24.1%, down from its 25.4% record high in June 2022), Financials (18.4, down from its 19.8 record high in August 2021), Real Estate (17.1, down from its 19.2 record high in 2016), Communication Services (15.4, down from its 17.0 record high in October 2021), Utilities (13.1, down from its 14.8 record high in April 2021), S&P 500 (12.4, down from its record high of 13.4 achieved intermittently in 2022 from March to June), Energy (11.0, down from its 12.8 record high in November), Materials (11.0, down from its 13.6 record high in June 2022), Industrials (10.6, new record high this week), Health Care (9.5, new record low this week and down from its 11.5 record high in February 2022), Consumer Discretionary (7.6, down from its 8.3 record high in 2018), and Consumer Staples (6.7, new record low this week and down from its 7.7 record high in June 2020).

S&P 500 Sectors & Industries Forward Profit Margin Since March 30 Bottom (*link*): The S&P 500's forward profit margin dropped 0.1ppt w/w to 12.4% as of the June 22, 2023 week. It's now up 0.1ppt from a two-year low of 12.3% during the March 30 week. Eight of the 11 sectors' margins have improved since then, with the S&P 500's gain paced by five sectors. It's still down 7.7%, or 1.0ppt, from its record-high 13.4% during the June 9, 2022 week, as nine of the 11 sectors' margins have declined since then, with the S&P 500's drop paced by just three of the 11 sectors. Here's the sector performance since the S&P 500's forward profit margin bottom on March 30: Communication Services (up 6.2% to 15.4%), Consumer Discretionary (up 3.4% to 7.6%), Industrials (up 3.1% to 10.6%), Information Technology (up 2.9% to 24.1%), Real Estate (up 2.5% to 17.1%), S&P 500 (up 0.8% to 12.4%), Consumer Staples (up 0.4% to 6.7%), Materials (up 0.2% to 11.0%), Financials (down 0.7% to 18.4%), Utilities (down 0.7% to 13.1%), Health Care (down 1.2% to 9.5%), and Energy (down 6.7% to 11.0%). These are the best performing industries since the March 30, 2023 bottom: Casinos & Gaming (up 59.4% to 6.1%), Publishing (up 24.4% to 3.0%), Passenger Airlines (up 14.1% to 6.0%), Multi-Sector Holdings (up 12.8% to 10.4%), Homebuilding (up 10.8% to 11.8%), Commodity Chemicals (up 10.5% to 6.5%), Gold (up 10.3% to 15.9%), Home Furnishings (up 9.6% to 5.9%), Wireless Telecommunication Services (up 8.5% to 12.4%), and Interactive Media & Services (up 8.4% to 21.7%).

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