Yardeni Research

MORNING BRIEFING
August 31, 2023

Hooray! The Job Market Is Rebalancing

The next *Morning Briefing* will be on Tuesday, September 5.

Check out the accompanying chart collection.

Executive Summary: The stock market has proven resilient so far this week, rallying despite the Fed chair's hawkish speech Friday. Several tailwinds have helped: The JOLTs report on Tuesday suggested the labor market is rebalancing, upping the odds that the Fed is done tightening. Joe's data show that analysts have been raising earnings estimates in recent weeks for all future periods they forecast and that more companies' outlooks have improved over the past three months than was true at the data's recent low point last year. The rolling recession in goods-related industries looks poised for a rolling recovery soon. … Also: Loan growth has been falling in the US and Europe, but the US economy remains resilient.

US Strategy: Forward Earnings Remains on Recovery Road. The stock market rallied from Friday through Wednesday despite Fed Chair Jerome Powell's hawkish *speech* at Jackson Hole on Friday. The rally received a bullish jolt from July's JOLTS report on Tuesday morning showing both fewer job openings and fewer quits than expected during the month.

These are bullish developments, as we discuss further below, because they suggest that the labor market is "rebalancing," with demand for labor easing. Powell has stressed the importance of these two variables for the setting of monetary policy. Both are heading in the right direction, i.e., the one that increases the likelihood that the Fed is done raising interest rates.

Also heading in the right direction are analysts' consensus expectations for the operating earnings of the S&P 500. During Q2, the actual result fell 5.3% y/y, led by a 48.0% y/y drop in the Energy sector. Excluding Energy, S&P 500 earnings rose 3.4%. Meanwhile, industry analysts have been raising their earnings estimates for 2023, 2024, and 2025 in recent weeks (*Fig. 1*). They've also been raising their estimates for the final two quarters of 2023 as well as all four quarters of 2024 (*Fig. 2* and *Fig. 3*).

There's no recession apparent in the analysts' consensus earnings forecasts. Let's review the latest data:

(1) *Quarterly.* Here are the actual and current expected y/y quarterly growth rates for 2023 (-3.1%, -5.3%, -0.1%, and 9.1%). Here are the expectations for 2024's quarters (8.8%, 12.0%, 12.7%, and 12.8%).

(2) *Annually.* The analysts are currently expecting that earnings on a "frozen actual" basis will rise 11.8% y/y next year to $247.09 from $221.01 this year, which would be up 1.3% from 2022 (*Fig. 4*). They expect 2025 earnings to increase 12.6% to $278.10.

(3) *Forward.* During the August 24 week, S&P 500 forward revenues rose to yet another record high (*Fig. 5*). S&P 500 forward earnings is still below its record high of $239.93 during the week of June 23, 2022. However, it bottomed this year during the February 9 week and is up 5.4% since then to $238.06 during the August 24 week. (FYI: Forward revenues and earnings are the time-weighted average of analysts' consensus expectations for the current year and following year. The forward profit margin is calculated by us from forward revenues and earnings.)

These two series suggest that the latest earnings recession was wholly attributable to the decline in the profit margin. Indeed, the forward profit margin fell from a record high of 13.4% during the week of June 9, 2022 to a recent low of 12.3% during this year's March 30 week. It rose to a seven-month high of 12.6% during the latest week of August 24.

(4) *Earnings breadth.* Joe calculates a series showing the percentage of S&P 500 companies with positive three-month percent changes in forward earnings (*Fig. 6*). It was up to 73.3% at the end of August from a recent low of 44.4% during the December 30 week of 2022.

(5) *Bottom line.* Joe and I believe that the earnings recession ended in Q2. Revenues growth is likely to slow along with inflation in our forecast. However, that should be more than offset by the ongoing rebound in the profit margin.

We are still estimating that S&P 500 earnings per share will be $225 this year, $250 next year, and $270 in 2025 (*Fig. 7*). We haven't changed these estimates since last November. They've been higher than the consensus of investment strategists mostly because we've been in the soft-landing rather than the hard-landing camp since last year.

Heads up: Once we have all the final numbers for Q2, we may shave our 2023 earnings estimate, but we will stick with our 2024 and 2025 numbers. Can you believe that we are already starting to think about 2025? That's because the market is probably starting to do so, and industry analysts already have earnings estimates that far out. How time flies!

US Economy I: Job Openings & Quits Falling. Job openings fell by 338,000 to 8.8 million during July, the lowest since March 2021 (*Fig. 8*). This series is highly correlated with the "jobs plentiful" series included in the monthly survey of consumer confidence. The latter fell from 43.7% saying so in July to 40.3% in August, the lowest since April 2021.

In discussing the "rebalancing" of the labor market in his Jackson Hole speech, Powell said: "Demand for labor has moderated as well. Job openings remain high but are trending lower." He views this as a favorable development. We do too, and so do the stock and bond markets.

In Powell's previous recent remarks on the labor market, he noted that the quits rate (which is reported along with job openings in the JOLTS report) is highly correlated with measures of wage inflation. He has been rooting for the quits rate to decline to reduce wage inflation. That seems to be happening. The quits rate for private industry fell from 2.7% during June to 2.5% during July, the lowest since November 2020. It tends to lead wage inflation by about six months (*Fig. 9*).

Workers tend to have a higher propensity to change jobs when there are more opportunities to get a pay increase by doing so. That certainly was the case last year. It's increasingly less so this year.

US Economy II: Rolling Recovery For Goods? Yesterday, Jackie reviewed the rolling recession that hit retailers especially hard during Q2 of this year; we reckon it actually started in late 2021 when consumers pivoted from buying lots of goods to purchasing lots of services. The good news is that the goods sector may soon experience a rolling recovery.

That's based on our reading of August's regional business surveys conducted by five of the 12 Federal Reserve district banks. The average of their general business indexes rose from a recent low of -16.5 during May to -6.2 during August (*Fig. 10*). This series is highly correlated with the national M-PMI, which was 46.4 during July. The August result will be released on Friday. We expect a reading up closer to 50.0.

Global Credit: Loan Growth Falling in US & Eurozone. Monetary policy works with a long and variable lag. The major central banks started tightening their monetary policies early last year in response to surging inflation. In the US, the yield curve inverted last summer, suggesting that the odds of a financial crisis triggering a credit crunch and a recession were increasing.

Sure enough, a banking crisis occurred during March of this year. However, it didn't morph into a credit crunch because the Fed responded quickly with an emergency lending facility for the banks. At the same time, Credit Suisse imploded in Europe. However, Europe's banking crisis also was contained; it didn't turn into a credit crunch.

Nevertheless, the yield curve remains inverted in the US. The growth rates of bank loans in the US and in Europe are falling. The US economy remains resilient, while the European economy is less so. Both will be weighed down by tightening credit conditions. Let's review the latest relevant data:

(1) *US bank loans.* The growth rate of loans and leases at all commercial banks in the US fell to 4.8% y/y during the August 16 week (*Fig. 11*). That's down from a recent peak of 12.5% during the December 7, 2022 week. That's a slowdown, but it isn't a credit crunch.

Here are the latest y/y growth rates of the banks' major loan categories: commercial & industrial (0.8%), commercial real estate (7.8%), mortgages (5.8%), and consumer credit (5.8%) (*Fig. 12*).

Also available on a weekly basis is consumer credit card balances at the banks, which is up 11.4% y/y (*Fig. 13*). Auto loans is down 2.2% y/y, signaling that credit conditions and demand are deteriorating in this segment of the banks' loan portfolios.

(2) *Eurozone MFI loans.* Outstanding loans held by the Eurozone's monetary financial institutions (MFIs) fell by €58 billion through July after having peaked at a record €13.1 trillion during last September (*Fig. 14*).

Calendars

US: Thurs: Headline & Core PCED 0.2%m/m/3.3%y/y & 0.2%m/m/4.2%y/y; Personal Income 0.3%; Nominal & Real Personal Consumption Expenditures 0.6%/0.0%; Initial & Continuous Jobless Claims 235k/1.709m; Chicago PMI 44.0; Natural Gas Storage; Collins. **Fri:** Payroll Employment Total, Private, and Manufacturing 170k/150k/1k; Average Hourly Earnings 0.3%m/m/4.4%y/y; Average Weekly Hours 34.3; Unemployment & Participation Rates 3.5%/62.6; ISM M-PMI & Manufacturing Prices 47.0/43.5; Construction Spending 0.5%. (Bloomberg estimates)

Global: Thurs: Eurozone Headline & Core CPI -0.1%m/m/5.1%y/y & 0.3%m/m/5.3%y/y; Germany Retail Sales 0.3%m/m/-1.5%y/y; Germany Unemployment Change & Unemployment Rate 10k/5.6%; Germany Import Price Index 0.0%; France GDP 0.5%q/q/0.9%y/y; France CPI 0.7%m/m/5.2%y/y; France PPI -3.3%; Italy Unemployment Rate 7.4%; Italy CPI -0.8%m/m/5.7%y/y; UK Nationwide HPI -0.3%m/m/-3.9%y/y; Japan Housing Starts -0.8%y/y; Japan Construction Orders 2.1%y/y; China Caixin M-PMI 49.4; ECB Publishes Account of Monetary Policy Meeting; Schnabel; De Guindos; Balz; Pill. **Fri:** Eurozone, Germany, France, Italy, and Spain M-PMI 43.7/39.1/46.4/45.9/48.8; Italy GDP -0.3%q/q/0.6%y/y; UK M-PMI 42.5; Canada GDP 1.2%q/q; Canada M-PMI 49.2. (Bloomberg estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The *Bull-Bear Ratio* was below 3.00 for the fourth successive week, dropping to 2.07 this week—the lowest since the last week in May—from 3.07 four weeks ago. *Bullish* sentiment retreated for the fourth week by 14.0ppts to 43.1% this week, after climbing the prior three weeks by 5.7ppts (from 51.4% to 57.1%)—which was the most bulls since November 2021 when it reached a danger level of 57.2%. Meanwhile, *bearish* sentiment climbed to 20.8% this week, after falling from 20.0% to 18.6% last week—fluctuating in a volatile flat trend the past couple of months. The *correction count* dipped to 36.1% this week, after increasing the prior three weeks, from 24.3% (the lowest since the start of the year) to 37.1%. Turning to the *AAII Sentiment Survey* (as of August 24), optimism fell this week, and is below average for the second straight week, while bearish sentiment is above average for the first time in 12 weeks. The *percentage expecting stock prices to rise over the next six months* fell for the third week, by 16.7ppts (to 32.3% from 49.0%). The *percentage expecting stocks to fall over the next six months* rose for the third month, by 14.6ppts (to 35.9% from 21.3%). That puts it above its historical average of 31.0%, after 11 consecutive weeks below. The *percentage expecting stock prices will stay essentially unchanged over the next six months* decreased 2.2ppts to 31.8%, putting it below its historical average of 31.5% for the ninth time in 12 weeks.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin rose 0.1ppt w/w to a seven-month high of 12.6% during the August 24 week. That's up from a 24-month low of 12.3% during the March 30 week, but is down 0.8pt from its record high of 13.4% achieved intermittently in 2022 from March to June. It's now 2.3pts above its seven-year low of 10.3% during April 2020. Forward revenues edged up less than 0.1% w/w to a new record high. Forward earnings rose 0.6% w/w to its highest level since

July 2022, and is only 1.0% below its record high during the June 16, 2022 week. Both had been steadily making new highs from the beginning of March 2021 to June 2022; prior to that, they peaked just before Covid-19 in February 2020. The consensus expectations for forward revenues growth rose 0.2ppt w/w to a 10-month high of 4.1% and is now up 1.8pts 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 rose 0.2ppt w/w to a 13-month high of 8.9%, and is now 5.4pts 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 2.3% in 2023 (down 0.2ppt w/w) and 4.8% in 2024 (up 0.5ppt w/w) compared to a revenues gain of 12.3% in 2022. They expect an earnings gain of 1.0% in 2023 (up 0.4ppt w/w) and an 11.6% 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 0.2ppt y/y to 12.0% in 2023 (up 0.1ppt w/w), compared to 12.2% in 2022, and to rise 0.8ppt y/y to 12.8% in 2024 (up 0.1ppt w/w). The S&P 500's weekly reading of its forward P/E was unchanged w/w at an 11-week low of 18.8 and is down from a 17-month high of 19.8 during the July 20 week. That's still 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 up 0.03pt w/w to 2.34, but that's down from a 15-month high of 2.46 during the July 27 week. That's up from a 31-month low of 1.98 in mid-October and 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 August 24 week saw consensus forward revenues rise for seven sectors and forward earnings rose for eight sectors. The forward profit margin moved higher for seven sectors. Two sectors have forward revenues at post-pandemic or record highs this week: Health Care and Utilities. Among the remaining nine sectors, only Energy and Financials have forward revenues more than 5.0% below their post-pandemic highs, while Materials is nearly in that doghouse. These three sectors have forward earnings at a post-pandemic or record high this week: Consumer Discretionary, Information Technology, and Utilities. Tech's was at a record this week for the first time in 15 months. These three sectors are less than 1.0% below that mark: Communication Services, Consumer Staples, and Industrials. Among the remaining five sectors, only Energy and Materials have forward earnings down more than 20.0% from their post-pandemic highs. All but the Industrials sector have seen forward profit margins retreat from their post-pandemic or record highs, but six of the 11 sectors are showing signs of recovering from their lows in early 2023.

Industrials' forward profit margin is at a record high again this week, but Health Care is at a record low. 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 four sectors are expected to see them improve y/y in 2023: Communication Services, Consumer Discretionary, Industrials, and Utilities. Here's how the sectors rank based on their current forward profit margin forecasts along with their record highs: Information Technology (24.8%, down from its 25.4% record high in June 2022), Financials (18.1, down from its 19.8 record high in August 2021), Real Estate (17.2, down from its 19.2 record high in 2016), Communication Services (16.2, down from its 17.0 record high in October 2021), Utilities (13.0, down from its 14.8 record high in April 2021), S&P 500 (12.6, 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 (10.8, record high this week), Health Care (9.3, record low this week and down from its 11.5 record high in February 2022), Consumer Discretionary (8.1, down from its 8.3 record high in 2018), and Consumer Staples (6.8, record low this week and down from its 7.7 record high in June 2020).

US Economic Indicators

ADP Employment (*link*): "This month's numbers are consistent with the pace of job creation before the pandemic," noted Nela Richardson, chief economist, ADP. "After two years of exceptional gains tied to the recovery, we're moving toward more sustainable growth in pay and employment as the economic effects of the pandemic recede." *Private payrolls* in August increased only 177,000, after blowing past forecasts the prior two months, climbing 312,000 in July and 455,000 in June. Total payrolls continued to reach new record highs in August, as employment in service-providing and goods-producing industries climbed 154,000 and 23,000, respectively, to new record highs. Within *servicing-providing* industries, education & health services (52,000) posted the biggest gain, followed by trade, transportation & utilities (45,000), leisure & hospitality (30,000), professional & business services (15,000), other services (7,000), and information services (5,000), while payrolls in the financial activities industry were flat. All were at new record highs except for information services, financial activities, and professional & business services—though the latter was within 113,000 of its record high. Within *goods-producing* industries, job counts in natural resources & mining have been soaring this year: The category added 5,000 jobs in July and 371,000 ytd, after losing 107,000 jobs last year. Meanwhile, construction jobs advanced for the seventh successive month, though the pace slowed; the industry added only 6,000 jobs in August—after averaging monthly gains of 56,800 the prior six months. As for manufacturing payrolls, they increased 12,000 in August after a five-month contraction of 197,000, though the level remains in record territory—within 224,000 of January 2019's record high. Turning to ADP's *median annual pay* measures, the yearly rate for *job-stayers* slowed to a 23-month low of 5.9% in August, down from last September's 7.8% peak, while the rate for *job-changers* eased to 9.5%, 6.9ppts below last June's 16.4% peak.

GDP (*link*): *Real GDP* for Q2 expanded a revised 2.1% (saar), slowing from the preliminary estimate of 2.4%. That followed gains of 2.0%, 2.6%, and 3.2% the prior three quarters—climbing 2.5% y/y to a new record high. There's no recession in these numbers. The revision to Q2 real GDP was primarily driven by a downward revision to real gross private domestic investment from 5.7% to 3.3% (saar), as nonresidential investment (to 6.1% from 7.7%) was weaker than first reported and inventory investment was also revised lower. Within nonresidential investment, the gains in both equipment (7.7% from 10.8%) and intellectual property products (2.2 from 3.9) were revised lower, while structures (11.2 from 9.7) was revised higher. Meanwhile, residential (-3.6% from -4.2%) investment declined at a slightly slower pace. *Real consumer spending*, which accounts for two-thirds of real GDP, increased 1.7% (saar) during Q2, a tick above the 1.6% preliminary estimate, with goods consumption was unchanged from its initial estimate of 0.7% (saar), though durable goods (-0.3% from +0.4%) spending was weaker than first reported and nondurable goods (1.2 from 0.9) spending slightly stronger. Services consumption (2.2 from 2.1) was little changed from its preliminary estimate. *Real government spending* (3.3% from 2.6%) was stronger than first reported, with both state & local (4.7 from 3.6) and federal (1.2 from 0.9) government spending higher than initial estimates. Turning to trade, the decline in exports (-10.6% from -10.8%) (saar) barely budged from the initial estimate, while imports (-7.0 from -7.8) declined at a slightly slower pace.

Contributions to GDP Growth (*link*): *Consumer* spending (1.14ppts) was the biggest positive contributor to real GDP growth during Q2, mostly *services* (0.99) consumption. The contribution from *goods* (0.15) spending was negligible, with nondurables goods (0.17) and durable goods (-0.2) barely registering. *Nonresidential* (0.80) investment was at the number-two spot, as spending on equipment (0.38) contributed positively to GDP growth for the first time in three quarters—with transportation equipment (0.54) accounting for the entire gain. Meanwhile, structures (0.30) and intellectual property products (0.12) also contributed to the gain, but not as much as equipment. *Government* spending (0.58) was the third biggest contributor to GDP growth during Q2, primarily state & local governments (0.50). Meanwhile, *trade* (-0.22) was the biggest drag on real GDP growth last quarter, as the negative contribution from exports (-1.26) more than offset the positive contribution from imports (1.04), followed by *residential investment* (-0.14), which was a negative contributor for the ninth straight quarter. Meanwhile, *inventory investment* (-0.09) exerted only a small drag on Q2 real GDP growth after a big 2.14ppt drag during Q1.

Global Economic Indicators

Eurozone Economic Sentiment Indicators (*link*): Neither the Economic Sentiment Index (ESI) for the EU nor the ESI for the Eurozone has posted a gain since January. The *EU's measure* fell 4.8 points to 92.9 during the seven months through August, while the *Eurozone's gauge* fell 6.3 points to 93.3—down from their January readings of 97.7 and 99.6, respectively; they were at record highs of 117.8 and 118.8 during October 2021. ESIs among the *six largest EU economies* were mixed in August, with ESIs in France (-2.5 to 91.4) and Germany (-2.4 to 88.6) once again posting the largest declines, followed by Italy (-1.1 to 100.3) this month. Meanwhile, sentiment improved in Spain (+1.5 points to 102.4) and Poland (+1.2 to 95.5) and was virtually unchanged in the Netherlands (+0.2 to 92.9). By sector, *consumer* confidence in the overall EU posted its first decline in 11 months in August, slipping 0.9 point to -17.0, following a surge of 13.7 points from last September's record low of -29.8. *Retail trade* confidence fell for the third time in four months, by 3.1 points, to -4.5, though managers were somewhat more optimistic about expected business conditions. *Industrial* confidence remains in a freefall since reaching a record high of 12.9 in December 2021, plunging 22.7 points over the period to -9.8 this August, while *construction* confidence continued its slide, deteriorating to -7.7 in August from a record high of 8.4 at the end of 2021. Meanwhile, *service* confidence dipped 3.7 points during the four months through August, from 7.5 to 3.8. It's down 15.7 points from its recent peak of 19.5 during October 2021.

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