PREDICTING THE MARKETS

Our Studies of the Financial Markets

Edward Yardeni

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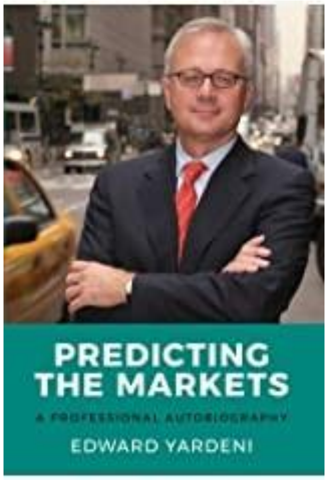
In 2018, I published *Predicting the Markets: A Professional Autobiography.* I've followed that up with a series of Topical Studies examining the issues that I discussed in my book but in greater detail and on a more current basis. Studies in this series, which are available on my Amazon Author Page, include:

In Praise of Profits! (2021)
The Fed and the Great Virus Crisis (2021)
S&P 500 Earnings, Valuation, and the Pandemic (2020)
Fed Watching for Fun and Profit (2020)
Stock Buybacks: The True Story (2019)
The Yield Curve: What Is It Really Predicting? (2019)

On the following pages are brief descriptions of our Predicting the Markets studies.

Please review on Amazon.



Predicting the Markets: A Professional Autobiography (2018)

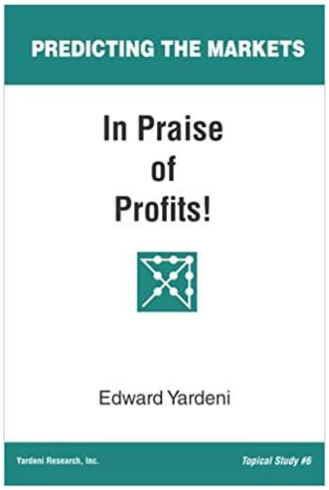
In *Predicting the Markets,* Edward Yardeni, legendary Wall Street economist and investment strategist, shares his insights and lessons learned forecasting the economy and financial markets over the past 40 years.

Ed Yardeni takes readers on a fascinating journey retracing the economic and financial ups and downs from the late 1970s through today. Along the way, he mines the lessons of the past for insights that inform how to be thinking about the future.

"Dr. Ed" was among the first Wall Street prognosticators to see the bullish consequences of disinflation and globalization for stocks and bonds during the 1980s and 1990s. He was the first economist on Wall Street to recognize the importance of Baby Boom demographic trends. In 1993, he started writing about the "High-Tech Revolution in the US of @"—presaging the enormous impact that technological advances would have on life today. After China joined the World Trade Organization in 2001, he foresaw the resulting commodity boom. Dr. Ed turned bearish on financial services stocks during June 2007 before the financial crisis hit with full force. Although he wasn't bearish enough on the overall stock market back then, he correctly called the market's bottom the week after it was hit in March 2009, remaining steadfastly bullish during the nine-year bull run through the start of 2018.

In *Predicting the Markets*, Dr. Ed explains his reasoning behind all these predictions. He also explores why so many conventional forecasting models have been so frequently wrong. His approach is based on common sense rather than complicated and often misguided theories. He demystifies what can often seem like a complex tangle of countervailing forces impacting financial markets. The result is a highly engaging how-to guidebook for profiting from outside-the-box thinking, while avoiding the groupthink of consensus forecasting. All the major issues that investors must sort through as they navigate financial markets are explained in a clear and logical way. Yet Dr. Ed's book can be read by anyone with an interest in financial markets and economics; no prior knowledge is necessary.

Dr. Ed believes everyone can benefit from a better understanding of the forces that shape our financial lives. Accordingly, *Predicting the Markets* is chock-full of important lessons not only for institutional investors but also for individual investors, business professionals, and students. When it comes to predicting the global economy and financial markets, Dr. Ed has literally written the book.

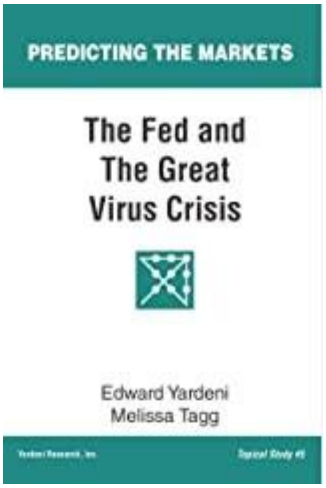


In Praise of Profits! (2021)

There has been much confusion about corporate profits. That's because there are several measures of profits and very little understanding of, or even interest in, how they differ. As a result, there has been lots of sloppy analysis and misinformed discussion of such important issues as the central role of profits in economic growth, the trend of profits, the corporate tax rate, the profit margin, profits' share of national income, and corporate share buybacks.

The confusion has played into the hands of progressives. They claim that free-market capitalism, driven by the profit motive, causes wage stagnation and results in both income and wealth inequality. They want the government to redistribute income and wealth by increasing taxes on the rich and on corporations. They refuse to acknowledge that profit-driven capitalism is the source of our nation's widespread prosperity. They say that the relevant data support their claims; that's not so, as I demonstrate in this book. I conclude that the entrepreneurial variety of capitalism should be allowed to flourish. If it does so, so will we all.

As I will show in this study, the progressives' narrative of the relationship between profits and prosperity is wrong and misleadingly pessimistic. In short, it's backward: Market-driven profit is the *source* of prosperity, not its nemesis. Ironically, profit is what drives the progress in standards of living that progressives champion and attempt to bring about with their policy approaches. But progressives seem blind to the progress that has been achieved and perpetually want to do more. In my opinion, progress has been made despite their persistent policy interventions thanks to the power of the profit motive to deliver profits and prosperity in a free-market economic system.



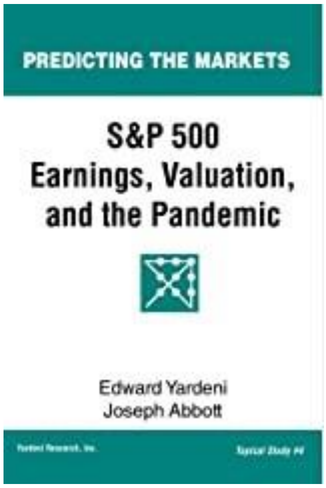
The Fed and The Great Virus Crisis (2021)

In this study, Edward Yardeni and Melissa Tagg, two of the world's preeminent Fed watchers, provide investors with a practical understanding of the forces that drove the Fed's monetary policy—as well as fiscal policies—during 2020 in response to the Great Virus Crisis.

At the beginning of the year, Fed Chair Jerome Powell and his colleagues expected that the longest economic expansion in US history would continue and that the federal funds interest rate would remain range-bound between 1.50% and 1.75%. The outlook changed dramatically for the worse on March 11, 2020, when the World Health Organization declared that Covid-19 had spread around the world. It was officially a pandemic.

That marked the beginning of the world war against the virus. It was a war on three fronts: the health front, the economic front, and the financial front. The Fed responded by the lowering its key interest rate to zero on March 15 and implemented an open-ended program of quantitative easing on March 23, "QE4ever." Various liquidity facilities that were used during the Great Financial Crisis were reopened and new ones added. Fiscal policy joined the battle, with substantial spending programs initiated. Collectively, these measures amounted to trillions of dollars of support.

In this study, the authors explain why this two-pronged monetary/fiscal response worked so well on the financial and economic fronts. They also consider its potential long-term consequences on inflation, financial stability, and the role of government in the economy.



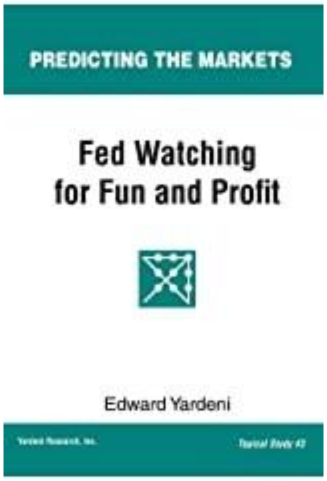
S&P 500 Earnings, Valuation, and the Pandemic (2020)

In this unique primer, Edward Yardeni and Joseph Abbott, who are among the most experienced and widely followed investment strategists, provide investors with a practical understanding of the forces that drive the stock market. This study focuses on the S&P 500 stock price index, examining how its performance is a function of the earnings of the 500 companies that are included in the index and the valuation of those earnings by the stock market. Notwithstanding occasional bear markets, the S&P 500 has been a great investment over the years—so much so that "S&P" could stand for "Success & Profit."

The first chapter in this study covers the various measures of earnings for the S&P 500 and why Ed and Joe favor forward earnings among them. The second chapter discusses various models of valuation, again focusing on the S&P 500. The final chapter uses the resulting analytical framework to review how it has worked in good times and bad, focusing on the Great Financial Crisis and the Great Virus Crisis.

The stock market discounts analysts' consensus estimates for revenues and earnings this year and next year on a time-weighted basis. So that's what Ed and Joe calculate weekly, which they call "forward revenues" and "forward earnings." These can provide very timely insights into the performance of the global economy as well as the underlying trends in quarterly revenues and earnings.

While this framework provides a disciplined approach to analyzing the macroeconomic fundamentals that are driving earnings, the valuation of those earnings by investors will always be much more subjective than objective. Nevertheless, there are many fundamental factors that influence valuation multiples. Some, like inflation and interest rates, will always be important in assessing the valuation question. Other factors may be relatively new and worthy of careful analysis.



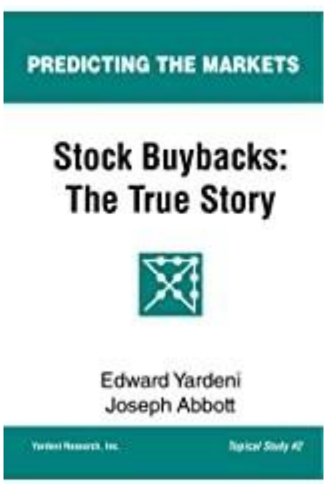
Fed Watching for Fun & Profit (2020)

In predicting activity in the major stock, bond, commodity, and foreign exchange markets around the world, nothing is more important than to anticipate the actions of the Federal Reserve System's Federal Open Market Committee (FOMC), which sets the course of monetary policy in the United States. By controlling the key interest rate in the money markets and other monetary variables, the FOMC has an enormous impact on the global economy and financial markets.

Watching the Fed closely are not only Wall Street's economists and investment strategists but also reporters and commentators at the major financial news organizations.

In fact, anyone involved in investment matters and business activities anywhere in the world needs to watch the Fed, because its policies powerfully affect not only the US economy but also the global economy. For participants in the financial markets, anticipating a policy change by the Fed and positioning an investment portfolio or speculative trade accordingly can result in big gains. Conversely, failing to anticipate a move by the Fed can result in big losses or missed opportunities for gains.

In this primer, Edward Yardeni, one of the world's foremost "Fed watchers," helps investors to understand the FOMC's decision-making process, anticipate its moves, and profit from those insights (that's the fun part!).



Stock Buybacks: The True Story (2019)

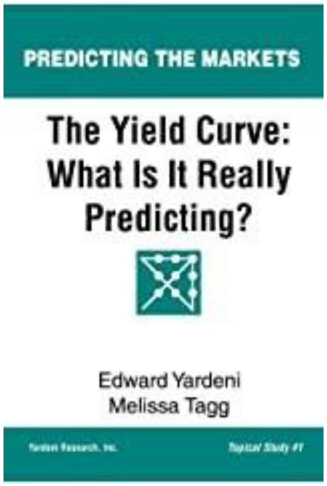
Several progressive politicians have pounced on corporate share buybacks lately. They see buybacks as a major source of income and wealth inequality, subpar capital spending, and lackluster productivity. In their opinion, buybacks have contributed greatly to the stagnation of the standards of living of most Americans in recent years. So they want to limit buybacks or even ban them.

Some of Wall Street's stock-market bears have been growling about buybacks as well. They've been arguing that buybacks have rigged the stock market in favor of the bulls. They claim that companies buy back their stock to boost their share prices, using debt to finance this dubious activity. As a result, corporate balance sheets have become increasingly leveraged, which makes them vulnerable to a recession. Widespread corporate leverage, in turn, would exacerbate any economic downturn. The bears therefore remain bearish and expect to be vindicated with a vengeance, eventually.

In this study, Edward Yardeni and Joseph Abbott show that the facts don't support either narrative. The most common reason that S&P 500 companies buy back their shares is to offset the dilution in the number of shares outstanding that results when employee compensation takes the forms of stock options and stock grants that vest over time, not just for top executives but for many employees. In effect, the ultimate source of funds for most stock buybacks is the employee compensation expense item on corporate income statements, not bond issuance as the bears contend.

The authors explain that the bull market in stocks has boosted buybacks to a greater extent than buybacks have boosted the market, whereas the opposite is more widely believed. Rising stock prices increase the attractiveness of paying some of employees' compensation with stock grants. Buybacks then are necessary to offset the dilution of earnings per share. While the latest bull market, like previous ones, has been driven by rising earnings, it's a Wall Street legend that earnings per share have been boosted artificially and significantly by stock buybacks. It may seem that way only because what lift buybacks have provided to stock prices is highly visible, occurring in the open market, whereas companies' need to offset stock issuance with stock repurchases is less apparent.

The authors also refute progressives' pervasive narrative that most Americans' standards of living have stagnated in recent decades and that buybacks per se have worsened income inequality.



The Yield Curve: What Is It Really Predicting? (2019)

The yield curve is now as widely followed by the financial press as movie stars are followed by paparazzi. The tabloids often comment on any noticeable changes in the physical features of the celebrities they stalk. Similarly, the financial paparazzi are obsessed with the shape of the yield curve.

The spread between the “long end” and the “short end” of the curve is widely deemed to be a great leading indicator of recessions when it goes negative. Such yield “inversions” do have a good track record of occurring several months before the start of recessions.

In this Topical Study, Edward Yardeni and Melissa Tagg explain that the yield curve neither predicts nor causes recessions. Instead, it predicts the monetary policy course likely to be pursued by the Federal Reserve. Among the topics covered are:

1. The relationship of the business cycle to the monetary and credit cycles.
2. How the shape of the yield curve anticipates financial crises and reacts to them.
3. The impacts of globalization on the US bond market and the shape of the yield curve.
4. How to use the yield curve to predict the Fed’s moves and to anticipate recessions, which are always bearish for stocks.

This study includes Dr. Ed’s “Primer on the Yield Curve,” based on the discussion in his book *Predicting the Markets* (2018). It also includes charts that illustrate the relationships of the yield curve to economic and financial market indicators. Readers will find these charts highly useful for gleaning insights into the activity to expect from the economy and financial markets.