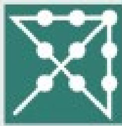
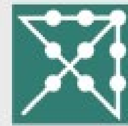
 Yardeni Research 

April 18, 2024

Morning Briefing

Financials, The Safety Trade & Small But Mighty Particles

Check out the accompanying chart collection.

Executive Summary: After the Q1 earnings reports of several big financial services firms, it's clear that those exposed to the financial markets through brokerage and investment banking arms lucked out while large commercial banks suffered. Jackie discusses the reasons behind the divergent performances. … Riskier S&P 500 sectors were all the rage during the October-March stock market rally; now that the market's tide has turned, will the "safe" sectors like Health Care and Consumer Staples get a turn to outperform? They haven't during the April sell-off so far. … Our Disruptive Technologies segment focuses on the cancer-fighting promise of drug-carrying nanoparticles, so small they can boldly go where traditional drug delivery methods can't.

Financials: Brokers Beat Bankers. At the risk of overgeneralizing, how well financial services firms did last quarter depended on which side their bread was buttered on. In general, the large commercial banks reported Q1 results that were hurt by a lack of loan growth, lower net interest income, and higher provisions for credit card and commercial real estate credit losses. Conversely, the investment banks benefitted from higher M&A and capital markets activity, more assets under management, and a lack of provisions for credit losses.

Bank of America's revenue fell 1.9% y/y (to $25.8 billion), but its EPS excluding a FDIC assessment dropped much more, by 11.7% (to $0.83). PNC's revenue fell 8.2% y/y (to $5.1 billion), and its EPS excluding the FDIC assessment declined by nearly twice that much, 15.6% y/y (to $3.36).

Conversely, Goldman Sachs's revenue jumped 16.3% y/y to $14.2 billion, while its EPS leapt by nearly twice that much, or 31.7% y/y (to $11.58). Morgan Stanley produced an EPS gain of 18.8% (to $2.02) on revenue up just 4.3% (to $15.1 billion).

The stock price indexes of the two industries have responded accordingly. The S&P 500 Investment Banking & Brokerage industry has outperformed the S&P 500 Diversified Banks

industry since April began. That's a reversal compared to the past year, when the Diversified Banks outperformed. Here's how the two industries' stock price indexes have performed over recent time periods through Tuesday's close: y/y (19.5% Investment Banks, 26.5% Diversified Banks), ytd (1.8, 5.7), mtd (-3.4, -8.3), w/w (-2.8, -7.1), wtd (2.9, -1.7).

It was a result we expected after looking at the lack of growth in C&I loans and the pickup in investment banking activity in last Thursday's *Morning Briefing*. Whether the brokers' good fortune will continue may depend on whether the financial markets hold up or whether they trip on higher-for-longer interest rates.

In the meantime, here are a couple of nuggets from some of the banks' and brokers' earnings reports and conference calls:

(1) *NII still falling.* If you're a glass-half-full person, you'd like to hear that BofA's Q1 net interest income (NII) rose slightly q/q to $14.0 billion from $13.9 billion in Q4-2023. However, on a y/y basis, NII fell from $14.6 billion in Q1-2023. The upcoming two quarters represent tough y/y comparisons, with NII higher in both quarters than it was in Q1. That said, NII will continue to benefit as low-interest-rate Treasuries in the bank's held-to-maturity book mature and are replaced with assets that have higher interest rates.

At PNC Financial Services Group, NII fell to $3.3 billion, a 9.0% y/y decline and a 4.1% q/q drop.

(2) *An eye on real estate.* Provisions for credit losses continue to climb at many banks. At BofA, they rose to $1.3 billion, up $215 million q/q and $388 million y/y. Net charge-offs continued to climb as well, to $1.5 billion, up $306 million q/q and $691 million y/y. The net charge-off jump was attributed to the credit card and commercial real estate areas.

BofA CFO Alastair Borthwick expects to see consumer net charge-offs level off over the next quarter or two because early-stage delinquencies have improved. As for commercial real estate, he said: "Roughly one-third of our office exposure is now categorized as reservable criticized and importantly, the pace of the increase in reservable criticized exposures has slowed each quarter since the second quarter of last year. So we believe the losses on these office properties have been front-loaded and largely reserved. We expect the losses to move lower in the second quarter, and we expect a notable decline in the second half of the year when compared to the first half of this year, absent any material change in expected real estate prices."

PNC's provision for credit losses declined last quarter to $155 million, down from $232 million in Q4-2023 and $236 million in Q1-2023. However, its net loan charge-offs increased to $243 million last quarter, up from $200 million in Q4-2023 and $195 million in the year-ago quarter.

(3) *Digitization and taxes.* BofA CEO Brian Moynihan highlighted the financial benefits the bank is reaping from the digitization of its operations. "The digitization activity is also driving ongoing expense cost savings, customer retention, and market share improvement," he said. "It also supports the ever-increasing volumes of client activity with little increased cost."

It took the bank's virtual banking assistant, Erica, four years to execute one billion transactions and only another 18 months for it to execute the second billion transactions. In addition, Zelle transactions last quarter outnumbered checks written and exceeded the amount of cash withdrawn from branches and ATMs.

BofA's tax rate was a surprisingly low 8%—or 9% if certain items are excluded. The bank benefited from tax credits related to investments in renewable energy and affordable housing, without which its tax rate would have been 26%. PNC's tax rate was 18.8%, Goldman's 21.1%, and JPMorgan's 21.2%.

Safety Sectors: Shelter During April Showers? The S&P 500's April sell-off has brought its six-month rally, from October through March, to an abrupt halt. During that time, the index gained an impressive 27.5%, so a few weeks of consolidating those gains might be just what the doctor ordered.

The S&P 500 has declined 3.9% during the month of April through Tuesday's close. While sell-offs like this often provide an opportunity for the index's "safety sectors" such as Consumer Staples and Health Care to outperform their "riskier" counterparts like Communications Services and Information Technology, that hasn't happened so far. Here's the performance derby for the S&P 500's 11 sectors so far in April: Communication Services (0.2%), Energy (0.1), Information Technology (-3.0), Industrials (-3.4), Consumer Staples (-4.2), Materials (-4.4), Utilities (-4.4), Consumer Discretionary (-4.6), Financials (-6.0), Health Care (-6.3), and Real Estate (-9.0) (*Fig. 1*).

The Consumer Staples sector has been dragged down this year by Drug Retail (-32.4%), with its only stock Walgreens Boots Alliance, and Personal Products (-8.9%) industries. Meanwhile, the Health Care sector is being weighed down by Managed Health Care (-

8.9%)—home to UnitedHealth Group—and Biotechnology (-3.3%).

Here's a quick look at what these slow but steady sectors have to offer:

(1) *Sideways shares.* The S&P 500 Consumer Staples and S&P 500 Health Care sectors' stock price indexes rallied sharply from the start of the Covid pandemic in early 2020 through early 2022. For the past two years, though, the indexes have basically moved sideways while the S&P 500 forged upward (*Fig. 2* and *Fig. 3*).

(2) *Slow but steady earnings growth.* Both the S&P 500 Consumer Staples and Health Care sectors have revenue and earnings that are expected to grow. The Staples sector is expected to grow earnings by 4.0% this year and 8.3% in 2025, while the Health Care sector's earnings are forecast to climb 9.9% this year and 17.7% in 2025. Both are on par with or slightly below the S&P 500's expected earnings growth of 9.9% this year and 13.6% in 2025 (*Fig. 4* and *Fig. 5*).

(3) *Split on P/E.* While the S&P 500 Consumer Staples sector's forward P/E, at 19.2, is slightly below recent historical levels, the Health Care sector's P/E of 18.2 is slightly above recent historical levels (*Fig. 6* and *Fig. 7*). Both sectors' forward P/Es are below the S&P 500's forward P/E of 20.6.

Both sectors also have forward earnings that as a percentage of the S&P 500's total forward earnings are less than their market-capitalization contributions to the larger index. For example, the S&P Consumer Staples sector contributes 6.2% of the S&P 500's total earnings but only 5.9% of the S&P 500's total market capitalization. The S&P 500 Health Care sector's forward earnings share is 13.4%, while its capitalization share is 12.1% (*Fig. 8* and *Fig. 9*).

Conversely, the S&P 500 Information Technology sector's forward earnings share of the S&P 500 is only 22.4%, below its 29.6% capitalization share. Even though the S&P 500 Communications Services sector is home to highly valued fast earnings growers like Google, Meta, and Netflix, its forward earnings share of the S&P 500, at 10.0%, is north of its capitalization share, at 9.3%; that's not surprising given that most of its constituents are lower-valued slower growers in the "old-economy" phone, cable, and publishing areas (*Fig. 10* and *Fig. 11*).

Disruptive Technologies: Thinking Small. Scientists are thinking small to get big results. Nanoparticles, which are 1 to 100 nanometers in diameter (a nanometer is about 1/100th the

size of a human hair), can flow through the bloodstream and penetrate tumor tissue. For many years, scientists have been working on how to harness these particles to battle cancer. They've had some success, with a handful of drugs approved, and more experiments are continuing to expand the number of cancers addressed by the new technology.

Professor Paula Hammond, head of MIT's Department of Chemical Engineering, is a pioneer in nanotechnology research. In this *TED Talk* from 2015, she explains how a nanoparticle contains a chemotherapy drug surrounded by siRNA, which is then surrounded by a polysaccharide, so that the patient's bloodstream doesn't attack and eliminate the nanoparticle. The nanoparticle penetrates the tumor, where its siRNA blocks the tumor's gene that would reject the chemotherapy drug, then the chemotherapy is deployed.

These nanoparticles work well in breast and ovarian cancer tumors that return and fail to respond to traditional chemotherapy, Hammond explained. Different siRNA and different chemotherapy drugs can be put into the core of the nanoparticles to address different tumors.

Another group of MIT scientists has designed a nanoparticle that can carry multiple cancer drugs to treat multiple myeloma. In a study of mice, the nanoparticle that carried three drugs shrank tumors much more than the three drugs did when injected into the body in the same ratio. When drugs are injected into the body separately, it's unlikely that they'll arrive at the cancer cell at the same time, a January 26, 2023 *MIT News* *article* reports explains. By using the nanoparticle, they arrive at the tumor site together, making them more potent.

Three MIT graduates are using this method of drug delivery to create new ways to cure solid cancers at their privately held company, Window Therapeutics. Other privately held companies developing nanoparticle therapies include ARIZ Precision Medicine, which is targeting lung, breast, and colon cancers, among others, and Blueberry Therapeutics, which is using nanotechnology to deliver drugs to cure fungal nail infections and athlete's foot. Cello Therapeutics surrounds its cancer-treating nanoparticles with a cell membrane made from human cells, which it believes makes the treatment more effective.

There's also some excitement about a nanoparticle sensor that could detect many different types of cancer with a urine test. "The nanoparticles are designed so that when they encounter a tumor, they shed short sequences of DNA that are excreted in the urine," an April 25, 2023 MIT *News* *article* reported. The test identifies different cancerous proteins and can signal how a tumor is responding to treatment. Certainly, a small but mighty

development.

Calendars

US: Thurs: Leading Indicators -0.1%; Philadelphia Fed Manufacturing Index 0.8; Initial Claims 214k; Existing Home Sales 4.20mu; ; Williams; Bowman; Bostic. **Fri:** Baker-Hughes Rig Count; Goolsbee. (FXStreet estimates)

Global: Thurs: Japan CPI 2.7%y/y; EU Leaders Summit; Eurogroup Meetings; Schnabel; De Guindos; Nagel. **Fri:** Germany PPI 0.0%; UK Headline Retail Sales 0.3%; Eurogroup Meeting; Mann; Nagel; Breeden. (FXStreet estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*):The *Bull-Bear Ratio* fell for the second week to 3.90 this week after climbing to 4.43 two weeks ago—which was the highest reading since February 5, 2018. *Bullish* sentiment retreated for the second week to 56.5% this week, after climbing the prior two weeks from 60.3% to 62.5%—which was the most bulls since summer 2021. (The bulls last exceeded 60.0% in April 2021 and July 2021, at 63.7% and 61.2%, respectively.) Meanwhile, *bearish* sentiment was unchanged at 14.5% this week, after falling from 15.2% to 14.1% two weeks ago—which was the fewest bears since 12.6% in late January 2018. The *correction count* rose for the second week to 29.0% this week from 23.4% two weeks ago, as the majority of the former bulls shifted to projecting a correction again this week. Turning to the *AAII Sentiment Survey* (as of April 11), optimism about the short-term outlook for stocks fell in the latest survey, while neutral sentiment and pessimism increased. The *percentage expecting stock prices to rise over the next six months* fell 3.8ppts to 43.4%—exceeding its historical average of 37.5% for the 23rd straight week. The *percentage expecting stocks to fall over the next six months* increased 1.8ppts to 24.0%, remaining below its historical average of 31.0% for the 23rd straight week. The *percentage expecting stock prices will stay essentially unchanged over the next six months* increased 2.0ppts to 32.5%, putting it above its historical average of 31.5%.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin ticked down 0.1pt w/w to 12.9% during the April 11 week from an 18-month high of 13.0% a week earlier. That's up from a 24-month low of 12.3% during the March 30, 2023

week, and is just 0.5pt below its record high of 13.4% achieved intermittently in 2022 from March to June. It's now 2.6pts above its seven-year low of 10.3% during April 2020. Forward revenues ticked up 0.1% w/w to a record high, but forward earnings dropped 0.4% from its record high a week earlier. It had hit that mark during the September 21 week for the first time since the June 16, 2022 week. Revenues and earnings 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 0.1pt w/w to an 80-week high of 5.2%. It has gained 2.9pts from its 33-month low of 2.3% during the February 23, 2023 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. The forward earnings growth forecast edged down 0.1pt w/w to 11.4% from a 29-month high of 11.5%. It's now 8.1pts above its 31-month low of 3.3% during the February 16, 2023 week. 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 4.5% in 2024 (unchanged w/w) and 5.8% in 2025 (unchanged w/w) compared to a revenues gain of 2.2% in 2023. They expect an earnings gain of 9.3% in 2024 (down 0.6pt w/w) and a 14.4% rise in 2025 (up 0.8pt w/w) compared to an earnings gain of 2.3% in 2023. Analysts expect the profit margin to rise 0.6ppt y/y to 12.5% in 2024 (down 0.1pt w/w), compared to 11.9% in 2023, and to rise 1.0ppt y/y to 13.5% in 2025 (unchanged w/w). The S&P 500's weekly reading of its forward P/E dropped 0.2pt w/w to 20.6 from 20.8 a week earlier and is down from a 26-month high of 21.1 the week before that. That's up from a 30-month low of 15.3 in October of 2022. It also compares to 23.1 in early September 2020, which was the highest level since July 2000, and to a 77-month low of 14.0 in March 2020. The S&P 500 weekly price-to-sales ratio fell 0.03pt to 2.66 from 2.69 a week earlier and is down from a 25-month high of 2.71 the week before that. That's up from a six-month low of 2.22 during the October 26 week and compares to a 31-month low of 1.98 in October 2022. That 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 during the April 1 week, seven had their forward revenues rise w/w, and seven had forward earnings move higher. The forward profit margin moved higher w/w for six of the 11 sectors. Five sectors have forward revenues at post-pandemic or record highs this week: Communication Services, Health Care, Industrials, Information Technology, and Real Estate. Among the remaining six sectors, only three have forward revenues more than 5.0% below their post-pandemic highs: Energy, Financials, and Materials. These two sectors have record-high forward earnings this week: Communication Services and

Information Technology. Consumer Discretionary, Consumer Staples, Industrials, and Utilities were in that camp in very recent weeks. Among the remaining five sectors, only Energy and Materials have forward earnings down more than 10.0% from their post-pandemic highs. Among the 11 sectors, only Industrials has weathered a broad margin retreat from post-pandemic or record highs. Now nearly all of the sectors are showing signs of recovering from their early 2023 forward profit margin lows. Communication Services, Consumer Discretionary, and Information Technology are the only sectors with their forward profit margin at a record high this week. In recent weeks, Industrials was in that camp as well. Energy's forward margin is edging up now from its February 23-month low, while those of Consumer Staples and Health Care remain at or close to their record lows. The annual profit margin is expected to fall y/y in 2024 for Energy, Materials, and Real Estate and improve for the other eight sectors. Here's how the S&P 500 and its 11 sectors rank based on their current forward profit margin forecasts along with their record highs: Information Technology (26.6%, a record high this week), Financials (18.7, down from its 19.8 record high in August 2021), Real Estate (16.5, down from its 19.2 record high in 2016), Communication Services (17.0, a record high this week), Utilities (13.6, down from its 14.8 record high in April 2021), S&P 500 (12.9, down from its record high of 13.4 achieved intermittently in 2022 from March to June), Energy (10.8, down from its 12.8 record high in November 2022), Materials (10.8, down from its 13.6 record high in June 2022), Industrials (10.6, down from its 10.8 record high in early April), Consumer Discretionary (8.8, a new record high this week), Health Care (8.6, a record low this week and down from its 11.5 record high in February 2022), and Consumer Staples (6.9, down from its 7.7 record high in June 2020).

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