Yardeni Research

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Morning Briefing

S&P 500 Earnings, Japan & India

Check out the accompanying chart collection.

Executive Summary: Today, Joe recaps Q1 results for the S&P 500's 11 sectors. Record highs in revenues, earnings and profit margins were scarce for reasons of seasonality, but improvements were broad based. More sectors than not logged y/y growth in revenues (eight), in earnings (eight), and q/q margin expansion (seven). … The Bank of Japan is contending with sticky inflation and bond yields above 1% for the first time in years. Will that quell the appetite for US Treasuries from America's largest foreign creditor? Eric dispels some myths on Japanese demand. … Melissa weighs in on India's election results, its pricey stock market, and its lofty economic goals.

Earnings: Broad Improvement for S&P 500 Sectors. In Monday's *Morning Briefing*, Joe and I discussed the S&P 500 companies' collective Q1 results. Today, we turn our attention to how the S&P 500's 11 sectors performed and discuss how much of an impact the growth leaders and laggards had on the S&P 500's overall results.

But first, a bit about Q1s historically. A look at the data since 2004 shows that Q1 revenues typically decline on a q/q basis because Q4 revenues are buoyed by retailers' holiday sales. Q1 earnings, on the other hand, have improved q/q in more cases than not (11 of the past 20 years), with most of those gains occurring during the ZIRP (zero interest-rate policy) years from 2008 to 2015. Q1s are the best quarter of the year for profit margins. They've improved q/q in every year since 2004 except for three.

An impressive aspect about this year's Q1 was that the profit margin rose q/q—to 12.0% from 11.7% in Q4-2023—even though revenues and EPS were down slightly on a q/q basis, by 3.8% and 0.8%, respectively (see our *S&P 500 Quarterly Metrics*).

Joe discusses the Q1 results by sector below:

(1) *Revenues.* Financials was the only sector with quarterly revenues at a record high in

Q1-2024. Since Q1 revenues typically fall q/q, we're not concerned that it was only one. (During Q4-2023, six sectors posted record-high revenues.) Q1 revenues rose y/y for eight of the 11 sectors (up from six in Q4-2023), turning positive for Industrials. But y/y revenues growth remained negative for a fifth straight quarter for Energy and Materials and for a fourth straight quarter for Utilities.

Here are the sectors' y/y revenue growth rates for Q1: Financials (9.9%), Communication Services (9.5), Information Technology (8.8), Health Care (7.5), Industrials (2.7), Consumer Discretionary (2.2), Consumer Staples (1.9), Real Estate (1.2), Energy (-0.4), Materials (-6.2), and Utilities (-9.2).

(2) *Earnings.* Communication Services and Financials were the only sectors with Q1 EPS at a record high, but that's up from just one—Information Technology—during Q4-2023. Health Care is the only sector with Q1 EPS at a record low in Q1. Q1 EPS rose y/y for seven of the 11 sectors, up from five in Q4-2023. Y/y growth turned positive in Q1 for Consumer Staples and Financials. It remained negative for a seventh straight quarter for Materials, a sixth quarter for Health Care, a fourth for Energy, and a second for Industrials.

Here are the sectors' y/y earnings growth rates for Q1: Communication Services (44.6%), Utilities (29.4), Information Technology (25.4), Consumer Discretionary (21.8), Financials (10.6), Real Estate (7.1), Consumer Staples (6.2), Industrials (-0.3), Materials (-21.2), Energy (-23.6), and Health Care (-24.9).

(3) *Quarterly profit margin*. The operating profit margin improved q/q for seven sectors in Q1, up from just one in Q4-2023. Health Care's margin fell to a record low in Q1 and is only about half the level of its record high of 11.8%, achieved in Q1-2022. None of the sectors had a record-high profit margin in Q1. In contrast, eight of the 11 sectors had a record-high profit margin during 2021's and 2022's quarters and the three remaining sectors did during 2023's: Consumer Durables, Financials, and Industrials.

Here are the quarterly profit margins for the 11 sectors: Real Estate (30.8%), Information Technology (26.1), Communication Services (18.4), Utilities (14.9), Financials (14.4), Energy (9.8), Materials (9.4), Industrials (9.1), Consumer Discretionary (8.1), Consumer Staples (6.8), and Health Care (6.6).

(4) *S&P 500 growth with & without the Mag-8, Energy, and Health Care.* According to our calculations, which look at y/y growth on a same-company basis, the S&P 500 had Q1 revenue growth of 4.1% y/y and Q1 EPS growth of 8.4%. Those healthy gains were driven

by the stellar growth posted by the Magnificent-8 stocks (i.e., Alphabet, Amazon, Apple, Meta, Microsoft, Netflix, Nvidia, and Tesla) despite continued deterioration among companies in the Energy and Health Care sectors.

Without the Magnificent-8's collective 10.5% y/y revenue gain and 48.8% EPS rise in Q1, S&P 500 revenues would have risen 3.9% instead of 4.1% and EPS 5.9% instead of 8.4%. Without the Energy sector, S&P 500 revenues and earnings growth would be 4.6% and 11.7%. Without Health Care, revenues would have risen 6.5% and earnings 13.9%.

What happens to the S&P 500's Q1 results if we remove the bad news from Energy and Health Care as well as the great news from the Magnificent-8? The underlying revenues and earnings for the remaining 435 companies grew 3.9% and 14.4%, respectively.

Japan: The Sun Sets on Ultralow Yields. Japan was the trendsetter of unconventional monetary policies, including expansive asset purchases and negative interest-rate policy (NIRP). But NIRP is no more. In March, the Bank of Japan (BoJ) raised its interest-rate target on overnight loans out of negative territory for the first time since 2007 to between zero and 0.1%. It also ceased buying exchange-traded funds and loosened its yield-curve control policy, allowing long-term bond yields to rise.

The Japanese bond market is responding swiftly: The yield on the 10-year Japanese government bond (JGB) recently rose above 1.00% for the first time since 2012 (*Fig. 1*). Now financial markets are worried that the US government's largest foreign creditor may be more attracted by domestic investment opportunities than the opportunities for higher yields overseas that it used to hunt down.

Let's review the outlook for demand by Japanese investors:

(1) The BoJ has finally been able to lay off its kitchen-sink approach to monetary policy because inflation has been sustained above the central bank's 2.0% target for roughly two years. Prices rose 2.5% on a y/y basis in April (*Fig. 2*).

(2) The spread between US and Japan 10-year yields is the biggest driver of the USD/JPY pair (*Fig. 3*). The spread has remained around a two-decade high for the past couple years, most recently around 3.4%, as the 10-year Treasury yield surged to between 4.00% and 5.00% and the JGB yield to between 0.00% and 1.00%. It wasn't uncommon for JGB yields to trade negative in recent years.

Because the US-Japan interest-rate differential has surged, the yen has been pounded despite tightening the BoJ's monetary policy. The Ministry of Finance (MoF) confirmed that it defended the yen twice around the 160 level in late April and late May, *CNBC* reported. The MoF also defended the currency several times in 2022 as global central banks hiked and the BoJ lagged behind.

(3) Japan holds $1.19 trillion of Treasuries, making the country America's largest foreign creditor by far (*Fig. 4*). Japan also buys plenty of sovereign debt from other countries. So it's no surprise that financial markets worry that higher interest rates in Japan will detract from US Treasury bond demand, raising the cost of capital. However, Japan's holdings have increased by about $100 billion over the last year. That's because Japanese investors are less sensitive to the dollar than many think.

Net purchases of foreign long-term debt surged to $140 billion in the week ended May 18 after net selling of smaller sums in the prior weeks (*Fig. 5*). Japan tends to buy foreign debt more than it sells. And a wave of selling in 2022 was replenished by purchases once yields were higher abroad.

(4) In theory, a stronger dollar against the yen weighs on demand because it's more expensive to hedge against currency fluctuations. But not all Japanese investors hedge. Government bodies like the MoF and Government Pension Investment Fund actually have a ton of unrealized gains from their unhedged Treasury holdings because their dollar-based returns are worth more in yen terms. Private investors can adjust the amounts they hedge as well.

(5) The inverted US Treasury yield curve puts pressure on foreign investment. That's because hedged investors have to sell their short-term rates (near-zero in Japan), buy US rates (5.3%, give or take), and then go buy long-dated US debt (4.4%). That's a money-losing trade. However, Japan has also been buying agency mortgage-backed securities, corporate debt, and other fixed-income products to earn extra yield. Treasury data show that Japanese investors own roughly $562 billion in non-Treasury US debt. And that's not to mention the $953 billion of US equities.

India I: Modi's Miss. Narendra Modi and his party officially won India's general election. Indian stocks hit a new record and the rupee gained against the dollar after exit polls showed his Bharatiya Janata Party (BJP) was likely to win enough seats to form the government. The exit polls quickly proved to be a huge head fake.

The BJP is set to win just 239 seats, short of the 272 needed by a coalition or party to form a government in the 543-seat parliament. Down significantly from the 303 seats won in 2019 (353 including the wider coalition of the ruling National Democratic Alliance), it'll be the first time since Modi's first term (2014) that India could be stuck with a shaky coalition government. The India MSCI fell 6.5% in local currency terms yesterday in response to the news (*Fig. 6*).

We're awaiting clarity on the makeup of the governing coalition. While India's economic growth momentum has been remarkable and Modi has helped turn the country into a less volatile emerging-market play, hodgepodge emerging market coalitions historically have been a bad bet. It doesn't help that the India MSCI is trading at a forward P/E of 22.5, a loftier multiple than even the S&P 500 (*Fig. 7*).

Modi's win was expected, and he will become only the second leader to retain the seat for a third five-year term.

(1) *Modi's guarantee*. Exit polls indicated that the economy was of paramount importance to voters. Concerns centered on the job market, inflation, and income inequality. India's finance ministry projects real GDP growth of around 7.0% this year and next year and reaching $5 trillion by 2027.

(2) Those are ambitious goals, but the economy has been roaring. Real GDP grew 7.5% y/y in Q1 (*Fig. 8*). CPI was 4.8% y/y in April, down from 7.6% y/y at the start of 2020 (*Fig. 9*). However, unemployment rose to 8.1% in April from 7.4% in March.

Modi's 2024 campaign manifesto, titled "Modi's Guarantee," is aimed at economic growth. Sparring with the opposition Indian National Developmental Inclusive Alliance in parliament will make it difficult to pass any significant legislation.

India II: Steaming Economy, Stocks & Temperatures. India is hot. In recent weeks, temperatures have pushed record highs in many parts of the country. India MSCI has also climbed to new records, boosted by rising forward earnings and multiples (*Fig. 10*). Consider some of the drivers of the growth:

(1) One of the major reasons Indian markets have done so well is the global decoupling from China. India boasts the world's largest population, at 1.4 billion, and has a growing *young workforce*. Trade wars, then Covid-19, induced many nations to reshape their supply chains. India's government took advantage by investing in its industrial capacity.

Manufacturing rose to a record high in March (not seasonally adjusted) (*Fig. 11*).

(2) India's stock market is less concentrated than other emerging markets. The India MSCI's top 10 constituents in terms of market capitalization (out of 136 companies) compose just 36.0% of the index's total float-adjusted market cap and span six sectors, according to the index's *fact sheet*.

India III: Giving Credit. India's bond market was having a Goldilocks moment, thanks to moderating inflation and roaring growth, until the election. Consider recent developments in Indian interest rates:

(1) S&P Global *upgraded* the country's sovereign government bond outlook to "positive" from "stable" just last week, while maintaining India's sovereign bond "BBB-" rating. S&P Global raised the outlook for India because of its robust economic growth, improved quality of fiscal spending, and gradual path to fiscal consolidation.

(2) India's projected growth, should Modi and the BJP manage to keep it on track, can help maintain its relatively moderate debt-to-GDP ratio of 83.0% as of Q3-2023 (*Fig. 12*). The Reserve Bank of India's (RBI) recent record-high dividend payment to the government for the previous fiscal year, which was double the budgeted amount, also has supplied greater fiscal room.

(3) The RBI lowered its main short-term repo rate to 4.0% during 2020, then raised it in a series of increases through May 2022 to 6.5%, where the rate still stands (*Fig. 13*). Should inflation continue to moderate, the RBI could lower interest rates this year and support bond prices. India's 10-year government bonds currently are yielding around 7.00%.

Calendars

US: Wed: ADP Employment Change 175k; ISM NM-PMI 50.5; S&P C-PMI & NM-PMI 54.4/54.8; MBA Mortgage Applications; Crude Oil Inventories & Gasoline Production. **Thurs:** Productivity & Unit Labor Costs 0.3%/4.6%; Initial Claims 215k; Atlanta Fed GDPNow 1.8%; Merchandise Trade Balance $69.8b; Natural Gas Storage. (FXStreet estimates)

Global: Wed: Eurozone, Germany, and France C-PMIs 52.3/52.2/49.1; Eurozone, Germany, France, and Italy NM-PMIs 53.3/53.9/49.4/54.5; France Industrial Production

0.5%; UK C-PMI & NM-PMI 52.8/52.9; Eurozone PPI -0.5%; BoC Interest Rate Decision 4.75%; McCaul. **Thurs:** ECB Interest Rate Decision & Deposit Facility Rate 4.25%/3.75%; Eurozone Retail Sales 0.2%; Germany Factory Orders 0.6%; Spain Industrial Production; Italy Retail Sales 0.3%; European Parliament Elections; Lagarde. (FXStreet estimates)

US Economic Indicators

JOLTS (*link*): Job openings fell again in April, signaling a potential weakening of the labor market, dropping to its lowest level since February 2021. *Openings* fell 296,000 in April and 754,000 during the two months through April to 8.1 million, still a relatively high number but down from the series peak of 12.2 million in March 2022. Prior to the pandemic in early 2020, the highest level of job openings recorded was 7.6 million. Openings reached 10.0 million in June 2021 for the first time in the history of the series going back to 2000. There were 6.5 million people unemployed in April, so there were 1.2 available jobs for each unemployed person. This ratio was at a recent high of 2.0 during March 2022. *By industry*, the biggest decreases in job openings during April occurred in health care & social assistance (-204,000), leisure & hospitality (-109,000), accommodations & food services (-97,000), and state & local education (-59,000), but increased in private education services (+50,000). *Separations* include quits, which are generally voluntary separations initiated by employees—serving as a measure of workers' willingness or ability to leave jobs. *Total quits* have been in a downtrend since peaking at 4.5 million during April 2022, but did increase 98,000 this April to 3.5 million, with private industry climbing 60,000 to 3.3 million, led by other services (+67,000), health care & social assistance (+48,000), construction (+42,000), and durable goods manufacturing (+39,000). *Hirings* rose in April by 23,000 to 5.6 million, with private industry climbing 40,000 to 5.3 million, led by durable goods manufacturing (+52,000), transportation, warehousing, and utilities (43,000), wholesale trade (31,000), and health care & social assistance (+24,000).

Auto Sales (*link*): Motor vehicle sales in May remained in a volatile flat trend around recent highs. *Total* sales rose to 15.9mu (saar) in May, up from its recent bottom of 14.9mu in January, and not far from its recent high of 16.1mu during December and June of last year. Total sales bottomed at 12.3mu in September 2021. *Domestic light truck* sales have hovered in a flat trend around 10.0mu (saar) since last May, increasing to 10.2mu this May. These sales bottomed at 7.3mu in September 2021. *Domestic car* sales edged up to 2.2mu (saar) in May, hovering in a flat trend around 2.0mu since September 2021. Turning to *imports*, they have been on an uptrend since May 2020, climbing from 2.6mu in May 2020 to 3.8mu this April before ticking down to 3.5mu (saar) in May.

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