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Morning Briefing

Essential Minerals, Retail & Crypto

Check out the accompanying chart collection.

Executive Summary: If only the US government had taken the threat of dependence on China's rare earth minerals more seriously when it had the chance, China wouldn't hold the trump card now. Jackie recaps the recommendations of a congressional study two years ago. … Also: Dollar store executives describe the budget-conscious consumer they saw last quarter and what Trump's tariffs mean for their bottom lines. … And in our Disruptive Technologies segment: Major US banks are exploring whether to jointly issue a stablecoin of their own in response to competition from cryptocurrency players.

Materials: Appreciating Rare Earth Minerals. "People who live in glass houses should not throw stones." That's a saying that President Trump should have taken to heart before slapping aggressive tariffs on Chinese imports, because China has one thing that the US lacks and needs: rare earth minerals. These minerals are necessary components of high-tech equipment like automobiles, robots, and military equipment.

China mines about 70% of the world's rare earth minerals, and it processes about 90% of them. In the wake of Trump's tariffs, China began to require exporters of rare earths to get licenses to sell their goods internationally—and those licenses have been slow to come when they've come at all. So the exports of these minerals from China has slowed to a crawl. There's a growing concern that global auto manufacturers will have to pause production if they can't get their hands on enough magnets made from rare earth minerals. The US is left to depend on a small company, MP Materials, to boost the production and processing of rare earth minerals domestically.

President Trump understandably is upset about the situation, and Secretary of State Marco Rubio countered China's moves by announcing plans to cancel the visas of Chinese students inside the US. China response: Calling Harvard a "party school" and touting its own universities. Chinese AI company DeepSeek expressed pride that its founders were educated in China.

Such ridiculous tit-for-tat among world powers could easily have been avoided. The US government has long known that America's dependence on China for rare earth minerals was a problem, but it never acted on the recommendations of the studies it had commissioned.

Most recently, the House Select Committee on the Strategic Competition between the United States and the Chinese Communist Party, established in 2023, warned in a December 12, 2023 *report* that the US was too dependent on China for rare earth minerals. Here are some of its suggestions that the US should have heeded:

(1) *Identifying the problem.* Robert Lighthizer, US Trade Representative during President Trump's first term, explained to the committee how the US and much of the world was dependent on China for numerous critical minerals and their refining and processing. China has leveraged its industrial policy—including economic controls, trade protectionism, low environmental standards, and technology transfer—to solidify its indispensable positioning. The committee believed that China would use its position as leverage in a prospective conflict with Taiwan.

"Congress must decrease the United States' reliance on the PRC [People's Republic of China] for these critical materials," the report concluded.

(2) *Concocting a plan.* The report also recommended creating a reserve of rare earth minerals to insulate US producers from price volatility and the US government from the PRC's prospective weaponization of the minerals. In the event that China were to flood the market with these materials, the US reserve could purchase the excess and stabilize the prices. Having such a price stabilization mechanism in place would entice more US companies to enter the rare earth mining industry.

The report suggested that Congress and the executive branch work to source these minerals from countries that are friendly to the US and that they create incentives, like tax breaks and prizes, to encourage domestic manufacturing. It recommended that the Commerce Department investigate whether dumping or other practices that distort the market for rare earth minerals and magnets are going on, in which case the department should impose "material injury tariffs."

Also recommended: Increasing recycling programs of government-owned products that have rare earths or magnets in them, working with colleges to increase the number of workers with the skills necessary to build a rare earth minerals industry, and studying deep seabed mining and its impact on the environment.

The report concluded: “Never before has the United States faced a geopolitical adversary with which it is so economically interconnected. … The United States now has a choice: accept Beijing’s vision of America as its economic vassal or stand up for our security, values, and prosperity.”

Again, that report was dated December 12, 2023! Did Peter Navarro (a.k.a. Ron Vara), Trump’s Senior Counselor for Trade and Manufacturing, read the report before he recommended that the President start a trade war with China?

Consumer Discretionary: Consumers Go Bargain Shopping. Dollar General and Ollie’s Bargain Outlet Holdings both cater to lower-income consumers looking for a bargain. Dollar General is much bigger, with almost 21,000 stores compared to Ollie’s 582. Both reported better-than-expected Q1 results on Tuesday, but Dollar General’s shares surged 15.9% on the report, while Ollie’s shares fell slightly—though they’ve soared 134% over the past three years versus Dollar General’s 48.9% decline.

On their Q1 earnings conference calls Tuesday, both retailers’ management teams had much to say about consumers, tariffs, and their results. Here are some quick takeaways:

(1) *Strapped consumers want bargains.* Dollar General’s CEO Todd Vasos shared insights into recent consumer behavior on the company’s *conference call*: “During our recent customer survey work, 25% of DG customers reported having less income than they did a year ago, and nearly 60% of our core customers noted that they felt the need to sacrifice some necessities in the coming year.” He added that more middle- and higher-income customers are shopping at Dollar General.

On Ollie’s *conference call*, CFO Robert Helm observed that customers have been exercising greater discretion over their purchase decisions: “Consumers are looking for value and prioritizing their spending around their immediate needs. We saw continued evidence of this in the first quarter. Demand for consumer staples was consistently strong throughout the quarter, while demand for certain seasonal categories was impacted by the weather,” he said, adding that seasonal categories started the quarter off soft due to unseasonable May weather.

(2) *Talking tariffs.* Dollar General’s imports are relatively small, with direct imports in the mid- to high-single-digit range of its overall purchases and about 70% of them from China.

Dollar General's indirect imports are about twice as much, with about 40% from China. The company did not increase its inventory to protect itself from tariffs; its inventory levels fell 5% y/y even as the store base increased by 156 stores.

"While the tariff landscape remains dynamic and uncertain, we expect tariffs to result in some price increases as a last resort, though we intend to work to minimize them as much as possible," said Vasos. Dollar General expects tariff rates to stay at current levels through mid-August, when President Trump's 90-day pause on increased tariff rates on goods from China is expected to expire. After that, tariff rates may jump to the levels announced on April 2.

To offset the impact of tariffs, Dollar General is negotiating with its vendors to reduce costs in several ways, including negotiating cost concessions, shifting production to other countries, reengineering products, and substituting products. Management expects to successfully mitigate "a significant portion of the anticipated tariff impact on our gross margin" but anticipates some "incremental pressure" on consumer spending.

Ollie's buys much of its inventory from companies that are going out of business in closeout sales. It has benefitted from the increasing number of retail store closings, including Big Lots, and supply-chain disruptions. There's a "tremendous amount" of excess inventory available for the company to purchase, and its own inventory was up 16% at the end of Q1.

As it buys more closeouts, Ollie's reduces its reliance on Chinese imports. Imports are about 20% of Ollie's mix, and management assumes current tariff levels will remain in place for the rest of the year.

Tariffs will take a larger bite out of Dollar Tree's Q2 results than expected. The company *warned* yesterday that it accepted delivery of some products while Trump's 145% tariffs on Chinese exports were in effect, resulting in $70 million of unexpected Q2 costs. Subsequent tariff-mitigation efforts should benefit the company during H2. The shares tumbled more than 5% Wednesday.

(3) *The results.* Dollar General gave an optimistic forecast for 2025 that includes sales rising 3.7%-4.7% this fiscal year (ending January), up from prior guidance of 3.4%-4.4%. Same-store sales are forecast to rise 1.5%-2.5%, and EPS are expected to hit $5.20-$5.80, up from $5.11 last year.

Results benefitted from Dollar General's expanding partnership with DoorDash and its ability to process both SNAP and EBT transactions on delivery orders. The company is also expanding its Retail Media Network, a digital advertising platform on its website, apps, and in-store.

Dollar General is in the S&P 500 Merchandise Retail stock price index, but its impact on index performance is overshadowed by Walmart and Costco. The index has risen 11.0% ytd through Tuesday's close (*Fig. 1*). Analysts expect margin pressure this year. Revenue is forecast to climb a modest 2.8% in 2025 and 5.1% in 2026, but earnings are thought likely to inch higher by 1.6% this year then jump 10.8% in 2026 (*Fig. 2* and *Fig. 3*). The industry's forward P/E is an unusually high 37.7 (*Fig. 4*).

Ollie's also raised its 2025 sales forecast but kept its earnings forecast unchanged. Sales are expected to total between $2.58-$2.60 billion this year, up from a prior $2.56-$2.59 billion. Same-store sales are forecast to grow 1.4%-2.2%, up from 1.0%-2.0% previously. The company didn't change its EPS forecast of $3.65-$3.75.

The retailer's Q1 sales rose 13.4% to $576.8 million, propelled by the opening of 25 stores and 2.6% same-store sales growth. Adjusted EPS rose to 75 cents, up from 73 cents a year ago and beating analysts' consensus estimate of 71 cents.

Disruptive Technologies: Big Banks Want in on Crypto. Some of the nation's largest banks—including JPMorgan, Bank of America, Citigroup, Wells Fargo—are discussing whether to work jointly to issue a stablecoin in an effort to beat back competition from the cryptocurrency industry, a May 22 *WSJ* *article* reported. Stablecoins are cryptocurrencies backed by the US dollar or cash-like assets like Treasuries and are expected to maintain a one-to-one ratio with the US currency. In the crypto world, investors use stablecoins to store cash or make purchases.

"Banks have been bracing for the possibility that stablecoins could become widely adopted under President Trump and siphon away the deposits and transactions they handle, particularly if big tech companies or retailers get in on the action," the article noted.

Let's take a look at why the nation's largest banks, after keeping the crypto industry at a distance for many years, may now blink:

(1) *Crypto's value has soared.* The crypto industry has ballooned to far larger than we'd ever expected, and it has gained legitimacy under the Trump presidency. The cryptocurrency's market capitalization is $3.4 trillion, according to *CoinGecko*. The vast

majority of the value comes from bitcoin, which has a market cap of $2.1 trillion, up more than 500% since the start of 2023 (*Fig. 5)*. The industry also includes more than 16,000 coins traded on more than 1,000 exchanges.

President Trump has been the industry's greatest cheerleader, vowing to make America a global leader in digital assets. Separately, Trump Media & Technology—in which he and family members hold large equity stakes—is a crypto player. Trump Media's Truth Social platform is working to offer a bitcoin exchange-traded fund for retail investors. Truth Social also plans to partner with Crypto.com to bring other crypto products to market. And Trump Media recently sold $2.3 billion of stock to fund the purchase of bitcoin, which it plans to hold.

(2) *Crypto players want into banking.* Several crypto firms want to get into traditional banking. Circle and BitGo, a crypto custodian, are among the firms planning to apply for bank charters or licenses, and Coinbase Global and Paxos are considering doing so, an April 21 *WSJ* *article* reported.

Anchorage Digital, the only crypto firm that has a bank charter, works with buy- and sell-side institutions to buy and sell crypto assets. Robinhood, which offers banking services through its partnership with Coastal Community Bank, has acquired Bitstamp, a European crypto exchange with institutional and retail clients.

(3) *Questionable characters remain*. While black-tie dinners with President Trump may make the crypto industry appear more respectable, bad actors abound. Most recently, crypto robbers have been kidnapping people to get their cryptocurrency. Kidnappers tried last month to abduct a woman in France whose father runs a French cryptocurrency exchange. In the same month, an Italian man in New York City was kidnapped and tortured in an effort to steal his crypto.

Calendars

US: Thurs: Initial Claims 235k; Nonfarm Productivity & Unit Labor Costs -0.7%/5.7%; Balance of Trade -$94.0b; Kugler; Harker. **Fri:** Nonfarm Payroll Employment Total, Private, Manufacturing 130k, 20k, -1k; Average Hourly Earnings 0.3%m/m, 3.7%y/y; Average Weekly Hours 34.3; Unemployment Rate 4.2%; Consumer Credit $10.9b. (FXStreet estimates)

Global: Thurs: Eurozone PPI -1.8%m/m, 1.2%y/y; ECB Monetary Policy Statement; Germany Factory Orders -1.0%; Italy Retail Sales 0.2%; China Caixin NM-PMI 51.1; Greene. **Fri:** Eurozone GDP 0.4%q/q, 1.2%y/y; Eurozone Retail Sales 0.1%m/m, 1.4%y/y; Eurozone Employment Change 0.3%q/q, 0.8%y/y; Germany Industrial Production -1.0%; France Industrial Production 0.3%; Japan Leading Indicators; Lagarde. (FXStreet estimates)

Strategy Indicators

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): During the April 4 week, the S&P 500's forward revenues, earnings, and margins all peaked at record highs. In the eight weeks since then through the May 29 week, all these measures have risen during just two of those weeks, with all but revenues rising in the latest week. Forward revenues and earnings are now 0.3% and 1.3% below their respective record highs. The forward profit margin of 13.5% is down just 0.1ppt from its record-high 13.6%. It is now 3.2ppts above its seven-year low of 10.3% during April 2020. The consensus expectations for forward revenues growth was steady w/w at 5.3%, just 0.5ppt below its 23-month high of 5.8% during the August 1 week. It has gained 3.0ppts 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 was also steady w/w, but at a 15-month low of 10.9%. From a longer-term perspective, that's just 0.5ppt below its 20-year average of 11.4% and slowing from a 38-month high of 14.3% during the December 12 week. That's down from its 23.9% reading at the end of April 2021, which was boosted by the recovery from the pandemic to its highest reading since June 2010 and up substantially from its record low of -5.6% at the end of April 2020. Analysts expect revenues to rise 4.6% in 2025 (unchanged w/w) and 6.0% in 2026 (unchanged w/w), compared to a 4.9% rise in 2024. They expect an earnings gain of 9.1% in 2025 (unchanged w/w) and a 13.7% rise in 2025 (up 0.2ppt w/w) compared to 2024's earnings gain of 11.4%. Analysts expect the profit margin to rise 0.6ppt y/y to 13.1% in 2025 (unchanged w/w) and 0.9ppt y/y in 2026 to 14.0% (unchanged w/w), compared to 2024's 12.5%. Looking at valuation data as of May 29, the S&P 500's weekly forward P/E ticked up 0.1pt w/w to a 13-week high of 21.4, up 2.2pts from a 16-month low of 19.2 during the April 17 week and just 1.0pt below its four-year high of 22.4 during the February 20 week. It's now 6.1pts above its 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 rose 0.02pt w/w to a 13-week high of 2.89, up 0.30pt from a 12-month low of 2.59 during the April 17 week and 0.14pt below its record-high 3.03 during the February 20 week. That's up from a six-month low of 2.22 during the October 26, 2023 week and compares to a 49-month low of 1.65 in March 2020.

S&P 500 Sectors Revenues, Earnings, & Margins (*link*): During the May 29 week, forward revenues rose for six of the 11 S&P 500 sectors, but forward earnings rose for only two. The forward profit margin rose for five sectors w/w. These two sectors had record-high forward revenues this week: Information Technology and Real Estate. These five are less than 0.8% from their recent record highs: Communication Services, Consumer Staples, Financials, Health Care, and Utilities. Among the remaining four sectors, Consumer Discretionary has dropped 2.1% from its mid-March record-high forward revenues, Industrials' is 2.6% below its early September record, and both Materials and Energy are the biggest laggards at 7.4% and 17.7% below, respectively. None of the 11 sectors had record-high forward earnings this week. These four sectors are less than 0.7% from their record highs: Communication Services, Financials, Information Technology, and Utilities. These five sectors are a bit further from their highs: Consumer Discretionary (5.5% below its March 6 record), Consumer Staples (2.4% below its January 2 record), Health Care (1.8% below its April 3 record), Industrials (1.7% below its April 3 record), and Real Estate (4.6% below its August 2022 record). Forward earnings remains depressed for the last two sectors, Energy and Materials, which are 41.8% and 27.4% below their respective highs during 2022. Looking at the forward profit margin, none of the 11 sectors were in the record-high club for a second week. From late 2024 through mid-May, these five sectors were in that club, and they still remain close: Communication Services, Consumer Discretionary, Financials, Industrials, and Information Technology. These four sectors are struggling, with their forward profit margins at or barely above cyclical or record lows: Consumer Staples, Energy, Health Care, and Materials. 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 (27.2%, up 0.1ppt w/w and down from its 27.6% record high in September, prior to low-margin Dell's addition to the index, which lowered the margin 1.3ppts then to 26.3%), Financials (20.2, up 0.1ppt w/w and down from its 20.3 record high during the May 8 week), Communication Services (19.1, down from a record high 19.2 during the May 15 week), Real Estate (16.3, down from its 19.2 record high in 2016), Utilities (14.6, down from its 14.8 record high in April 2021), S&P 500 (13.5, down from its 13.6 record highs in early April), Materials (10.6, up 0.2ppt from 51-month low in late February and down from a 20-month high of 11.6 in July 2023 and a 13.6 record high in June 2022), Energy (8.5, at a 55-month low and down from its 12.8 record high in November 2022), Industrials (11.0, down from its 11.3 record high in early January), Consumer Discretionary (9.1, down from a record high 9.4 in early April), Health Care (8.4, at a record low and down from its 11.5 record high in

February 2022), and Consumer Staples (6.7, a 21-month low and down from its 7.7 record high in June 2020).

US Economic Indicators

ADP Employment (*link*): "After a strong start to the year, hiring is losing momentum," noted Nela Richardson, chief economist of ADP. "Pay growth, however, was little changed in May, holding at robust levels for both job-stayers and job-changers." *Private payroll* employment rose only 37,000 in May, falling short of both the consensus estimate of a 111,000 gain and April's 60,000 increase. The *service-providing sector* added just 36,000 jobs last month, with its industries experiencing a mixture of job gains and losses: leisure & hospitality (38,000), financial activities (20,000), information services (8,000) and other services (4,000) were in the plus column last month, while professional & business services (-17,000), education & health services (-13,000), and trade, transportation, and utilities (-4,000) posted declines. Meanwhile, *goods-producing* employment was cut by 2,000, as jobs in natural resources and mining (-5,000) and manufacturing (-3,000) cut payrolls, while construction companies added 6,000 jobs during the month. *By size*, medium establishments (49,000) added to payrolls, while small (-13,000) and large (-3,000) establishment cut jobs during the month. According to the report, the yearly pay increase for *job-changers* rose by 7.0%, unchanged from April, while pay gains for *job-stayers* was little changed at 4.5%.

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