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Morning Briefing

China, Staples & Quantum Computers

Check out the accompanying [chart collection](#).

Executive Summary: Now that China and the US are negotiating nicely, Jackie explores the pain their standoff caused businesses on both sides of the Pacific and the compromises recently struck. Were investors who bet the new deals struck would benefit semi stocks be proven right? ... Also: The S&P 500 Consumer Staples sector holds some industries with share price indexes that have surged northward in recent months and others that have surged southward. Today, we look at the two extremes and reasons for their disparate performances. ... And: IBM announces a quantum-computing leap: It has discovered a way to make a “fault tolerant” quantum computer that corrects its own mistakes.

China: The Trade Standoff Ends in a Draw. The trade standoff between China’s President Xi and US President Trump is over—for now at least. Both sides seem to have realized that they faced mutually assured destruction if the US put 145% tariffs on Chinese goods and China withheld the sale of rare earth minerals to US manufacturers.

Going forward, the question is: Which country will be the first to eliminate its vulnerability? Will the US develop rare earth minerals processing facilities slower or faster than China can reduce its dependence on US exports and high-end semiconductors?

Here’s a look at where things stand now after the Xi-Trump trade standoff:

(1) *A taste of the potential damage.* The trade skirmishing between the US and China only lasted a few weeks, but that was time enough to give both sides a more tangible sense of what they could be in for with a cutthroat trade war.

Rumblings of the trade war caused US imports from China to surge as merchants stocked up on goods manufactured in China. But when the tariffs actually kicked in, US imports of Chinese goods dried up. Chinese shipments to the US sank 35% y/y in May, the biggest percentage decline since February 2020, when Covid shutdowns hurt trade flows.

The skirmish has started to impact China's manufacturing machine. China's Caixin manufacturing purchasing managers index dropped sharply, from 50.4 in April to 48.3 in May ([Fig. 1](#)). And the slowdown in the manufacturing sector appears to have increased the deflationary pressures in China as factory gate prices dropped 3.3% in April y/y, the largest decline in a year.

The US wasn't unscathed. In May, Ford Motor shut down for about 10 days production at its Chicago assembly plant, where it makes the Ford Explorer and Lincoln Aviator, because it lacked the minerals needed in its braking systems. Several Asian and European auto manufacturers had to pause production due to the lack of rare minerals as well.

China agreed to the restoration of rare earth export licenses for US manufacturers, but only for six months, maintaining its leverage in future negotiations, a *WSJ* [article](#) reported yesterday.

(2) *Will semis win too?* In return for China's selling US companies rare earth minerals again, the US government agreed to relax restrictions on US companies selling to China ethane and jet engines and parts as well as allow Chinese students to attend US universities.

Negotiators did not say whether the US had agreed to sell China more of the US's most sophisticated semiconductors. But many investors seem to have thought so: The stock price indexes of the S&P 500 Semiconductors and the S&P 500 Semiconductor Equipment both outperformed the Information Technology sector on Monday and Tuesday of this week. The Semiconductor Equipment industry index jumped 5.2%, while the Semiconductors industry index gained 1.9%; the broader Technology sector inched up only 0.7% ([Fig. 2](#)).

Consumer Staples: A Look at the Good & the Bad. At first glance, the S&P 500's Consumer Staples sector seems to be gliding through 2025 with ease. Its 5.7% return ytd through Tuesday's close makes it one of this year's top performers among the S&P 500's 11 sectors. But there's a lot going on beneath this sector's surface. Its component industries have a wide variety of ytd returns, bracketed by Tobacco's strong 38.2% ytd gain and Brewers' sharp 9.1% ytd loss.

Here's the performance derby for the S&P 500 and its sectors ytd through Tuesday's close: Industrials (9.1%), Communications Services (7.8), Utilities (6.0), Consumer Staples (5.7), Materials (5.5), Financials (5.3), Real Estate (3.2), S&P 500 (2.7), Information Technology (1.8), Energy (-1.4), Health Care (-1.7), and Consumer Discretionary (-4.7) ([Fig. 3](#)).

Now consider the wide ranging ytd performances of the S&P 500 Consumer Staples sector's industries: Tobacco (36.9%), Drug Retail (21.7), Consumer Staples Merchandise Retail (7.4), Consumer Staples (5.7), Soft Drinks (3.7), Personal Products (-1.2), Packaged Food (-2.5), Household Products (-2.8), and Brewers (-8.9) ([Fig. 4](#)).

The industries' performances can often be traced to company-specific events. The stock price index of the S&P 500 Tobacco industry has benefitted from a popular new chewing pouch, while the Drug Retail industry's stock price index popped on news of the \$24 billion acquisition of Walgreens Boots Alliance. Conversely, trouble with its 2023 Hostess acquisition has hurt JM Smucker's results, and tariffs have taken a toll on a swath of food companies and brewers. Let's take a look:

(1) *Nicotine pouches are hot.* Philip Morris International sells tobacco products internationally, but it's the company's newest product, Zyn nicotine pouches, that has lit a fire under its stock. Zyn pouches don't contain tobacco, but they do contain a powdered form of nicotine derived from tobacco leaves that release nicotine when chewed on. The pouches are discrete and have flavors like mint, coffee, and cinnamon.

Philip Morris's shipments of Zyn jumped 53% y/y in Q1, boosting the company's revenue from smoke-free products up to 42% of total revenue. Analysts expect Philip Morris's adjusted earnings to climb from \$4.52 a share in 2024 to \$7.47 this year and \$8.27 in 2026. Its shares have rallied 48.8% ytd and 72.7% over the past year.

The other stock in the S&P 500 Tobacco industry is Altria Group, which had a 13.7% decline in US tobacco product volumes but an 18% jump in the volumes of on! nicotine pouches during Q1. Altria shares are up 12.0% ytd and 26.0% over the past year.

The excitement about these new products has pushed the S&P 500 Tobacco stock price index to new record highs for much of this year ([Fig. 5](#)). The industry's revenues per share and earnings per share have also been hitting record levels this year ([Fig. 6](#) and [Fig. 7](#)). Revenue is expected to grow 5.1% this year and 5.5% in 2026, while earnings are forecast to jump 9.9% this year and 7.3% next year. The Tobacco industry's forward P/E has certainly improved, but it remains below the S&P 500's forward P/E and is still below its own record P/E level ([Fig. 8](#)).

(2) *Trouble selling Twinkies.* JM Smucker surprised Wall Street with an earnings forecast for its fiscal 2026 (ending April 30) that was much lower than expected. The food company has struggled with its 2023 acquisition of packaged baked goods maker Hostess, price

increases on green coffee beans, and tariffs. The shares fell 15.6% on Tuesday's news.

Smucker expects fiscal 2026 adjusted EPS to hit \$8.50-\$9.50, below the \$10.25 Wall Street was expecting and below fiscal 2025's \$10.12. Adjusted for divestitures, Smucker's net sales decreased 1% y/y to \$2.1 billion for the fiscal quarter ending April 30, and its diluted EPS fell 13% to \$2.31, better than the \$2.24 analysts expected.

The company took non-cash impairment charges totaling \$980 million related to its \$5.6 billion Hostess acquisition. Consumers "continue to be selective in their spending, largely driven by inflationary pressures and diminished discretionary income, causing the sweet baked goods category to recover slower than we anticipated," said CEO Mark Smucker in the prepared earnings [remarks](#). He also attributed some of the underperformance to the company's management of the division.

However, the snack category in general has been difficult for many companies. Some analysts attribute the underperformance to the growing number of people taking drugs like Ozempic for weight loss and swapping salty and sugary snacks for high-protein snacks, like Greek yogurt and meat sticks. It's quite a turnabout from the pandemic, when our couch potato habits invited junk food.

Smucker is also dealing with price increases on green coffee that it has had to pass through to consumers and declining sales in its pet food segment. The company has felt the impact of tariffs on the green coffee beans it imports into the US as well as the impact of retaliatory tariffs on goods it produces in the US and sells in Canada, like peanut butter, coffee, and ice cream toppings. The company believes the direct and indirect impacts of tariffs hurt last quarter's EPS by \$0.25.

Smucker isn't the only packaged food company having a tough time of things. The S&P 500 Packaged Foods stock price index has fallen 2.5% ytd and 25.5% from its May 5, 2023 peak ([Fig. 9](#)). The industry's revenues have been essentially flat in recent years and are expected to inch up 1.4% this year and 2.0% in 2026 ([Fig. 10](#)). Its earnings growth prospects remain lackluster as well: After earnings dropped 8.0% in 2023, they were up 2.4% in 2024, but a decline of 6.9% is forecast for 2025 improving by 6.6% in 2026 ([Fig. 11](#)).

The best thing about the industry is its depressed forward P/E of 16.3 times EPS ([Fig. 12](#)).

Disruptive Technologies: IBM's Quantum Leap Forward. IBM announced on Monday

that it will be able to deliver a large-scale, fault-tolerant quantum computer by 2029. The powerful computer will include 100 million quantum gates on 200 logical qubits. Key to producing a fault-tolerant quantum computer is an ability to correct the errors that pop up in quantum systems, which IBM now feels confident it can do.

“We’ve cracked the code to quantum error correction, and it’s our plan to build the first large-scale, fault-tolerant quantum computer,” said Jay Gambetta, vice president of IBM Quantum, according to an [article](#) in IEEE Spectrum. “We feel confident it is now a question of engineering to build these machines, rather than science.”

Here’s a quick look at other major developments in the industry:

(1) *Many companies in the quantum race.* IBM is one of many companies chasing the quantum brass ring. Amazon, Google, and Microsoft each recently introduced quantum computing chips. In addition to the tech giants, many smaller companies are developing systems. One of them, IonQ, a US quantum computing company, announced earlier this week its plans to acquire UK startup Oxford Ionics for \$1.1 billion. Together, they plan to develop systems that have 256 qubits in 2026, more than 10,000 qubits by 2027, and two million qubits by 2030.

(2) *Solving the AI energy problem.* It may be more energy efficient to run artificial intelligence (AI) programs on quantum computers than it is to run AI programs on traditional computers. In one study, the quantum computer used 30,000 times less energy to complete the AI task than a classical super computer, a January 25 [article](#) in Quantinuum reported. The company has been “rebuilding” machine learning techniques for Natural Language Processing using quantum computers.

(3) *Security problems ahead.* It is possible that quantum computers will be able to break the encryption that protects everything from bank accounts and email to online transactions and national secrets. Analysts believe that Q-Day (when quantum computers can break encryption codes) will arrive anywhere from 2029 through 2055. The bad guys are thought to be planning ahead, gathering encrypted data today that they will be able to unlock in the future using quantum computers. And members of the crypto community are debating whether quantum computers will be able to break the encryption used on the blockchain. If they can, the entire world of crypto currency could be at risk, unless a new generation of encryption is established.

Calendars

US: Thurs: Headline & Core PPI 0.2%/m/m, 2.6%/y/y & 0.3%/m/m, 3.1%/y/y; Initial Claims 240k; WASDE Report. **Fri:** University of Michigan Consumer Sentiment 52.5. (Source: FX Street)

Global: Thurs: UK GDP -0.1%/m/m, 0.7%3m/3m; UK Headline & Manufacturing Industrial Production -0.4%/m/m, -0.4%/y/y & -0.8%/m/m, -0.4%/y/y; De Guindos; Schnabel; Elderson. **Fri:** Eurozone Industrial Production -1.5%; Germany CPI 0.1%/m/m, 2.1%/y/y; France CPI -0.1%/m/m, 0.7%/y/y; Spain CPI 0.0%/m/m, 2.1%/y/y; Japan Industrial Production -0.9%; Elderson. (Source: FX Street)

Strategy Indicators

S&P 500 Earnings, Revenues, Valuation & Margins ([link](#)): The S&P 500's forward revenues and profit margin attained a record high during the June 5 week, and its forward earnings improved to 0.2% below its April 4 record high. The forward profit margin is back up to a record high of 13.6% and is now 3.3ppts above its seven-year low of 10.3% during April 2020. The consensus expectations for forward revenues growth rose 0.1ppt w/w to 5.4%, just 0.4ppt below its 23-month high of 5.8% during the August 1 week. It has gained 3.1ppts 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 rose 0.4ppt w/w to 11.3% from a 15-month low of 10.9%. From a longer-term perspective, that's just 0.1ppt 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 4.5% in 2025 (down 0.1ppt w/w) and 6.1% in 2026 (up 0.1ppt w/w), compared to a 4.9% rise in 2024. They expect an earnings gain of 9.0% in 2025 (down 0.1ppt w/w) and a 13.8% rise in 2025 (up 0.1ppt 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 June 5, the S&P 500's weekly forward P/E ticked up 0.1pt w/w to a 14-week high of 21.5, up 2.3pts from a 16-month low of 19.2 during the April 17 week and just 0.9pt below its four-year high of 22.4 during the

February 20 week. It's now 6.2pts 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 0.03pt w/w to a 14-week high of 2.92, up 0.33pt from a 12-month low of 2.59 during the April 17 week and 0.11pt 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 June 5 week, forward revenues rose for 10 of the 11 S&P 500 sectors, and the forward earnings and profit margin rose for all 11 sectors. These five sectors had record-high forward revenues this week: Communication Services, Health Care, Information Technology, Real Estate, and Utilities. These two are less than 1.0% from their recent record highs: Consumer Staples and Financials. Among the remaining four sectors, Consumer Discretionary has dropped 1.6% from its mid-March record-high forward revenues, Industrials' is 2.1% below its early September record, and both Materials and Energy are the biggest laggards at 6.9% and 17.5% below, respectively. These four sectors had record-high forward earnings this week: Communication Services, Financials, Information Technology, and Utilities. These five sectors are a bit further from their highs: Consumer Discretionary (4.3% below its March 6 record), Consumer Staples (1.8% below its January 2 record), Health Care (1.1% below its April 3 record), Industrials (0.5% below its April 3 record), and Real Estate (3.3% below its August 2022 record). Forward earnings remains depressed for the last two sectors, Energy and Materials, which are 40.9% and 26.3% below their respective highs during 2022. Looking at the forward profit margin, nine of the 11 sectors rose w/w, and these two were back in the record-high club: Communication Services and Financials. From late 2024 through mid-May, these three sectors were also in that club, and they still remain close: Consumer Discretionary, 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 (27.3%, 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 (20.4, up 0.2ppt w/w to a record high), Communication Services (19.2, up 0.1ppt w/w to a record high), Real Estate (16.4, up 0.1ppt w/w and 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 (13.6, up 0.1ppt w/w to a record high), Materials (10.7, up 0.1ppt w/w and 0.3ppt 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 (8.6, up 0.1ppt w/w from a 55-month low

and down from its 12.8 record high in November 2022), Industrials (11.1, up 0.1ppt w/w and down from its 11.3 record high in early January), Consumer Discretionary (9.2, up 0.1ppt w/w and down from a record high 9.4 in early April), Health Care (8.5, up 0.1ppt w/w from 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

Consumer Price Index ([link](#)): The CPI was lower than expected again in May. The headline & core CPIs both ticked up 0.1% in May, below consensus estimates of 0.2% and 0.3%, respectively. The yearly rates also came in lower than expected, with the headline rate at 2.4% and the core rate at 2.8%, below the consensus estimates of 2.5% and 2.9%, respectively. The yearly headline rate was little changed from April's four-year low on 2.3%, while the core rate remained at April's 2.8%. In May, shelter costs increased 0.3% and was the primary factor in the increase in the headline CPI, with food costs also contributing to the advance—both the food at home and food away from home measures rose 0.3%. Meanwhile, the energy index dropped 1.0%, with gasoline prices sinking 2.6% and utilities falling 1.0%. Contributing to the increase in core prices during April were medical care, motor vehicle insurance, household furnishing & operations, personal care, and education. Partially offsetting those gains were price declines in air fares, used cars and trucks, new vehicles, and apparel.

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, 732-241-6502
Melissa Tagg, Senior Global Investment Strategist, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
William Pesek, Contributing Editor, 516-277-2432
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

