



MORNING BRIEFING

September 20, 2018

Rotating Tech & Flying Taxis

See the [pdf](#) and the [collection](#) of the individual charts linked below.

(1) Bull market rotating again and again. (2) Tech under attack by regulators and protectionists. (3) Semi Equipment industry also feeling pain of protectionism? (4) Tech margins keep notching records. (5) New Communications Services sector: New home for some FANGs. (6) Communications sector offers more offense, less defense. (7) Flying cars?

Tech I: Rotating Sectors. While the S&P 500 has recently been hitting new highs, the performance of its underlying sectors has changed radically in the past three months ([Fig. 1](#)). The market's growthiest sector, Technology, has gotten trounced by some of the market's most defensive sectors.

The S&P 500 Utilities, Health Care, and Telecom sectors have outperformed the Tech sector by more than six percentage points since June 14. Here's the performance derby through Tuesday for the S&P 500 sectors' stock price indexes: Utilities (9.7%), Health Care (9.5), Telecom Services (9.2), Consumer Staples (7.0), Real Estate (5.5), Industrials (5.5), S&P 500 (4.4), Consumer Discretionary (4.2), Tech (2.7), Financials (2.4), Materials (-1.0), and Energy (-1.6) [Table 1](#)

The market's defensive turn continued during September with the Tech sector straggling behind the other 10 S&P 500 sectors. Here's September's derby for the S&P 500 sectors' stock price indexes: Industrials (3.5), Telecom Services (3.1), Consumer Staples (1.5), Utilities (1.5), Health Care (0.9), Energy (0.5), Materials (0.3), S&P 500 (0.1), Consumer Discretionary (-0.1), Financials (-0.4), Real Estate (-1.2), and Tech (-1.9) ([Fig. 2](#)).

The Tech sector's impressive earnings growth this year hasn't been enough to offset concerns about the threat of government regulation, tariffs, and slowing growth among some of Tech's largest industries, particularly the S&P 500 Internet Software & Services industry and the Semiconductor Equipment industry. Let's take a deeper look into the S&P's largest sector, which represents 26.2% of the S&P 500's market capitalization and kicks in 23.5% of its earnings ([Fig. 3](#)).

(1) *Washington's punching bag.* Several high-profile tech stocks have been wilting under the hot glare of Washington's politicians. And unfortunately, there's little indication that they'll be allowed off the hot seat any time soon. Facebook, Twitter, and Google were all asked to appear before Congressional committee hearings earlier this month. The first two showed up.

Facebook shares are down 9.2% ytd and down 26.3% from its July 25 peak through Tuesday's close. The stock plunged 19.0% on July 26, after Facebook reported disappointing Q2 earnings, in which the company warned sales growth would slow and spending would rise to enhance users' security and privacy.

Twitter is actually up 21.7% ytd, but it too is down from July 25 by 33.9%. Perhaps, Google made the right decision by not showing up for a congressional grilling; its shares are up 10.8% ytd, but down only

9.2% from July 25. With Facebook under pressure, the S&P 500 Internet Software & Services stock price index has fallen 7.7% since June 14.

Analysts have been cutting their forecasts for Facebook's earnings. This week JP Morgan's analyst reduced his 2019 earnings target to \$7.40 a share from \$7.89. Facebook's "investments in 2019 could be larger than anticipated in consensus estimates. We expect the narrative of heavy investment spending to continue at 3Q earnings," the JP Morgan analyst wrote, according to a 9/18 CNBC [article](#). "Safety and security, around which FB will add 20k+ heads this year, will fall across multiple opex lines, but comes with little/no immediate revenue return."

That said analysts continue to call for the S&P Internet Software & Services industry to grow earnings by 20.4% this year and 18.5% in 2019. That's down from the 2019 22.5% earnings growth that was expected during June 2017, but it's not exactly shabby either ([Fig. 4](#)).

(2) *Semi equipment hurting*. Among the worst performing industries in the entire S&P 500 since June 14 is the Semiconductor Equipment industry, down 17.0% ([Fig. 5](#)). A decline in capital spending on equipment by semi chip makers has hurt the semi equipment companies.

"In mid-July, [Taiwan Semiconductor Manufacturing] lowered its projected capital expenditures by 13%. Samsung hasn't formally changed its projected capex yet for this year, though several analysts have reported the company delaying equipment orders as it adjusts its manufacturing operations. Samsung and TSMC combined accounted for about 46% of the chip industry's total capital spending last year, according to estimates from Wes Twigg of KeyBanc Capital Markets," a 8/18 *WSJ* [article](#) reported.

So far, sales of semiconductors continue to increase, implying the drop in equipment sales may be short lived if the US/Chinese trade war is not protracted. Global sales of semis hit \$39.5 billion in July, based on the three-month average, up 17.4% y/y and up 0.4% m/m, according to the [Semiconductor Industry Association](#) ([Fig. 6](#)).

Analysts aren't optimistic. The S&P 500 Semiconductor Equipment industry is expected to see revenues swing from a 24.3% increase this year to a 0.8% decline in 2019 ([Fig. 7](#)). Likewise, earnings, which are forecast to grow 48.5% this year, are targeted to drop 3.0% next year ([Fig. 8](#)). And analysts have been reducing their forecasts over the past two months through August after increasing them every month since January 2016 ([Fig. 9](#)).

(3) *Lots of margin to lose*. Looking into 2019, Tech earnings look attractive in isolation and relative to other industries in the S&P 500. Here's the earnings growth analysts are forecasting for the S&P 500 sectors next year: Energy (26.0%), Industrials (12.4), Consumer Discretionary (12.0), Tech (11.0), S&P 500 (10.3), Financials (9.6), Health Care (8.1), Materials (7.6), Consumer Staples (5.9), Utilities (4.7), Telecom Services (3.3), and Real Estate (0.0).

Investors should keep an eye on Tech operating margins, which are extraordinarily high relative to the sector's history and relative to the margins of other sectors. Tech's record high forward profit margin of 23.0% has climbed sharply since hitting a recession low of 11.7% in February 2009, and it's well above the pre-recession high of 13.9% in August 2008 ([Fig. 10](#)).

Here's how forecasts for the S&P 500 Tech sector's 2019 operating profit margins stack up relative to other S&P 500 sectors: Tech (23.0%), Financials (19.3), Real Estate (16.0), Telecom Services (14.0), Utilities (12.7), S&P 500 (12.5), Materials (11.5), Health Care (10.8), Industrials (10.5), Consumer Discretionary (8.2), Energy (7.9), and Consumer Staples (7.6).

Tech II: ChaChaChaChanges. This may be the last time we pen a piece on the “old” S&P 500 Technology sector because on September 21 it’s changing radically. Facebook, Alphabet, Twitter, Activision Blizzard, Electronic Arts, and Take-Two Interactive are expected to be plucked from the Tech sector and inserted into a new S&P 500 Communication Services sector. In addition, eBay will move from Tech to the Consumer Discretionary sector.

That means companies representing roughly 21% of the current S&P 500 Technology sector’s market cap are being shifted into the new Communication sector, according to calculations by State Street Global Advisors. The firm put out a detailed [report](#) on what these changes will mean for investors. Here are some of the highlights:

(1) *Consumer Discretionary changing too.* The Consumer Discretionary sector will also be undergoing major surgery. About 22% of the current sector’s market weight will be shifted into the Communication sector. The companies being transferred are expected to include: Omnicom Group, Interpublic Group, CBS, Discovery Communications, Comcast, Charter Communications, Dish Network, Walt Disney, Twenty-First Century Fox, Viacom, News Corp., Netflix, and TripAdvisor. The Communication sector will also absorb the Telecom Services sector.

(2) *The new sector’s stats.* When all the shuffling is complete, the new Communication Services sector will owe 27% of its market cap to companies that were formerly in the Consumer Discretionary sector, 54% of its market cap to names that were formerly in the Tech sector and 19% of its market cap to the Telecom Services sector.

The new Communication Services sector will represent about 10% of the S&P 500’s market cap, replacing the Telecom Services sector which only represented 2% of the S&P 500’s market cap. The new Communication sector will also be more global, with 35% of its revenues coming from overseas, versus the Telecom Services sector, which has 3% of revenues from overseas.

(3) *More growth, less value.* Because of its constituents, the new Communication Services sector will be far more “growthy” than the old Telecom Services sector, which includes high-dividend payers AT&T and Verizon. State Street calculates that 61% of the new Communication Services sector will be composed of growth stocks, compared to the current Telecom Services sector, which holds 100% value stocks.

This new, growthy Communication Services sector has historically produced above-market revenue and earnings growth. The new sector would have generated 19.8% revenue growth over the past three years and 26.0% earning per share growth over the same period, compared to the S&P 500’s 6.1% and 11.3% growth. The new Communication Services sector is expected to have a P/E of 15.7, based on data from July 31, far higher than the Telecom Services 6.6 P/E.

As a result, Communication Services won’t be the bond proxy the Telecom Services sector has been considered. State Street believes the new sector will be more sensitive to the equity market than the bond market, which isn’t surprising given the dividend yield of Communication Services is under 2%, while the dividend yield was more than 5% for the Telecom Services sector. The new sector is also expected to be more cyclical than the historically defensive Telecom Sector.

Tech III: Up, Up and Away. Last week during his Potcast, Elon Musk spoke about solving city congestion by either building underground tunnels or inventing flying cars. He has concluded that flying cars aren’t viable because they are too noisy and create too much air flow, we reported in last Thursday’s [Morning Briefing](#).

Don't tell that to the numerous companies working to develop flying cars, which often look like mini-helicopters. Here's a peek at what the believers are working on.

(1) *Uber on the job.* Uber is well aware that the noise levels of flying taxis need to be reduced. The company is working with the University of Texas to address the problem and make its flying taxis one half as loud as a medium-sized truck passing a house. "In order to make that happen, researchers plan to design stacked rotors that travel in the same direction, an evolving concept that they say would decrease noise," according to an 8/9 [article](#) in *The Austin American Statesman*.

The firm, which aims to begin demonstration flights in 2020 and start commercial flights in 2023, has chosen Dallas, Los Angeles, and Dubai as its launching cities.

"Uber has said it is looking for partners that can meet its technology specifications — electric-powered, minimal noise, and vertical take-off and landing capabilities — as well as a company that can scale production to build tens of thousands of vehicles to meet the demand of Uber's on-demand service," noted a 5/8 [article](#) in *The Verge*. The company was working with established companies Embraer and Bell Helicopter, along with new comers Aurora Flight Sciences, which was purchased by Boeing last year, Karem, and Pipistrel Vertical solutions.

(2) *Japan's flying car project.* Japan hopes that it will have a flying car that can light the torch at the 2020 Tokyo Olympics. "Major carrier All Nippon Airways, electronics company NEC Corp. and more than a dozen other companies and academic experts hope to have a road map for the plan ready by the year's end," according to a 9/18 CBS News [report](#).

The Asia Times brought up a number of obstacles the country will have to surmount, in an 8/30 [article](#). Japan is only spending \$40 million on the effort. It will have to open its wallet much wider if it is serious. There are also the regulatory problems that flying cars will face in any city; everything from safety, insurance, liability, zoning, and training requirements, just to throw out a few roadblocks.

(3) *Many contenders.* There are many companies and innovators trying to turn flying cars into a reality. Digital Trends highlighted six flying cars in an 8/19 [article](#). Some consider themselves VTOLs, or vertical take-off and landing aircraft. Opener Blackfly has a single seat, electric VTOL that can travel 25 miles on a charge at a top speed of 62 miles per hour.

Passenger Drone is developing a self-driving, 16-rotor drone a human can ride in. "The machine will be controlled by a touchscreen, and promises to take off with just one button. Users can then draw their route on a map, and have the drone fly them there, using a range of smart autonomous technologies to do so without accidentally running into anything on the way," the article explains.

Aston Martin is in the game with Volante Vision, a hybrid-electric flying car, which can takeoff and land vertically. It holds three passengers. While Lilium Aviation has a VTOL jet, which it hopes will carry either two or five people. The five-seater should fly for 60 minutes on a single charge.

Perhaps the most mind-blowing idea comes from British inventor Richard Browning, who's developing Gravity Industries' flying exosuit. It's a jet suit that has five engines and retails for \$446,000. The company expects the price will come down and an electric version will be available. If you want your jaw to drop, check out the video at the end of the article. Hello Iron Man.

CALENDARS

US. Thurs: Leading Indicators 0.5%, Jobless Claims 210k, Philadelphia Fed Manufacturing Index 19.2,

Existing Home Sales 5.360mu, EIA Natural Gas Report. **Fri:** C-PMI, M-PMI, and NM-PMI Flash Estimates 55.1/55.0/55.0, Baker-Hughes Rig Count. (Econoday estimates)

Global. Thurs: Eurozone Consumer Confidence -2.0, UK Retail Sales Excluding & Including Auto Fuel 2.3%/2.3% y/y, Japan CPI Headline, Core, and Core-Core 1.1%/0.4%/0.9% y/y. **Fri:** Eurozone, Germany, and France C-PMI Flash Estimates 54.5/55.4/54.6, Eurozone, Germany, and France M-PMI Flash Estimates 54.5/55.7/53.4, Eurozone, Germany, and France NM-PMIs 54.4/55.0/55.2, France GDP 0.2%q/q/1.7%m/m, Canada CPI -0.2%m/m/2.8%y/y, Japan M-PMI Flash Estimate. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): Our Bull/Bear Ratio (BBR) climbed this week for the sixth time in seven weeks from 2.90 to 3.26 over the period, back near its six-month high of 3.31 two weeks ago. Bullish sentiment rose 4.5ppts (to 59.0% from 54.5%) over the seven-week period, while the correction count fell -3.8ppts (22.9 from 26.7). Two weeks ago bullish sentiment was at 60.0%, while the correction count was at 21.9%—which was the highest reading for the former and the lowest reading for the latter since the final week of January. Meanwhile, bearish sentiment was once again little changed, inching down to 18.1% this week; it has fluctuated in a narrow band between 17.6% and 18.8% the past 16 weeks. The AAI Ratio declined for the second week to 49.4% last week, after a four-week increase from 47.6% to 64.1%. Bullish sentiment fell from 43.5% to 32.1% over the two-week period, while bearish sentiment rose from 24.4% to 32.8%.

S&P 500 TCJA Earnings Leaders & Laggards ([link](#)): The 2018 earnings forecast for the S&P 500 has surged 10.7% in the 38 weeks since the TCJA was signed into law on December 22. This outstanding performance has no comparison over the years since consensus earnings forecasts were first derived in 1978. The rate of change in the consensus forecasts has slowed since the Q1 earnings season, as analysts appear to have fully incorporated lower tax rates into their estimates. The top sector gainers since the TCJA was passed: Energy (38.7%), Telecom (19.8), Financials (13.4), Materials (13.2), and Industrials (11.5). Consumer Staples is now the smallest gainer, with an increase of 1.2%; also underperforming the S&P 500 are Utilities (2.6), Real Estate (4.5), Consumer Discretionary (7.5), Health Care (8.1), and Tech (8.5). Higher oil prices have contributed heavily to the improvement in Energy's 2018 earnings forecast.

S&P 500 Earnings, Revenues & Valuation ([link](#)): S&P 500 consensus-per-share forecasts for forward revenues and earnings rose to record highs again last week. As more weight is placed on the lower 2019 y/y growth expectations for revenues and earnings, their forward growth rates will continue to fall. During the latest week, the forward revenues growth forecast dropped 0.1ppt to 5.8%, and forward earnings growth slipped 0.8ppt to an eight-month low of 12.6%. Forward revenues growth is little changed from an 80-month high of 6.3% at the end of February, and forward earnings growth is down from 16.9% in February, which was the highest since October 2010. Forward revenue growth was 5.5% prior to the passage of the TCJA, and forward earnings growth was 11.1% then. Turning to the annual revenue growth expectations, the forecasts improved 0.1ppt to 8.4% for 2018 and 0.1ppt to 5.2% for 2019. Looking at annual earnings growth, the 2018 forecast rose 0.1ppt to 23.2%, and the 2019 forecast was steady at 10.3%. The forward profit margin remained steady at a record high of 12.4%, which is up from 11.1% prior to the passage of the TCJA in December and from a 24-month low of 10.4% in March 2016. The S&P 500 ex-Financials forward growth forecasts dropped 0.2ppt w/w to 5.9% for revenues and fell 0.6ppt to 12.2% for earnings. The S&P 500 ex-Financials forward profit margin rose 0.1ppt to a record high of 11.5%, and is up from 10.4% before the TCJA. Valuations were broadly higher w/w primarily due to the rise in the index's price to new record highs. The S&P 500's forward P/E remained steady at a six-month high of 16.7, which compares to a 16-year high of 18.6 at

the market's prior peak in late January and its recent low of 16.0 in early May. The S&P 500 price-to-sales ratio was steady at an eight-month high of 2.11, which compares to late January's record high of 2.16 and early May's low of 1.95.

S&P 500 Sectors Earnings, Revenues & Valuation ([link](#)): Consensus forward revenue and earnings forecasts rose w/w for seven of the 11 of the S&P 500 sectors. The per-share measures for both forward revenues and earnings are at or around record highs for 4/11 sectors: Consumer Discretionary, Health Care, Industrials, and Tech. Forward margins are at record highs for 8/11 sectors, all but Energy, Health Care, and Real Estate. Energy's forward revenues and earnings are back on uptrends after stalling during 2016-2017, and its earnings has about tripled from the 18-year low in April 2016. Looking at last week's readings for forward revenue and earnings growth among the 11 sectors, most fell w/w as more weight was place on their lower 2019 y/y growth expectations. Forward P/S and P/E ratios remain below their recent highs in early 2018 for all sectors. Energy's valuations remain elevated relative to historical levels, but are slowly returning to normal now after soaring in 2016 when revenues and earnings collapsed. Energy's P/S ratio of 1.20 compares to a record high of 1.56 in May 2016, and its P/E of 15.9 is down from a record high of 57.5 then. Due to the TCJA, higher margins are expected y/y in 2018 for all sectors but Real Estate, but that sector's forward earnings includes gains from property sales and typically improves as the year progresses. During the latest week, the forward profit margin fell for Real Estate and rose for four sectors: Energy, Financials, Information Technology, and Utilities. Here's how the sectors rank based on their current forward profit margin forecasts: Information Technology (23.0%), Financials (19.1), Real Estate (16.2), Telecom (14.0), Utilities (12.7), S&P 500 (12.4), Materials (11.3), Health Care (10.7), Industrials (10.3), Consumer Discretionary (8.1), Consumer Staples (7.6), and Energy (7.6). Energy's forward profit margin is near the highest level since December 2014. Among the remaining 10 sectors, all but two (Real Estate and Health Care) are at or near recent record highs.

US ECONOMIC INDICATORS

Housing Starts & Building Permits ([link](#)): August housing starts were a surprise on the upside, while building permits sank to a 15-month low. Total starts rebounded a larger-than-expected 9.2% to 1.282mu (saar), after a two-month slide of -11.7%. Volatile multi-family starts led last month's advance, soaring 29.3% to 406,000 units (saar), after plunging -19.7% the previous two months. Builders broke ground on 876,000 single-family units (saar), recovering 2.9% over the two months through August, following June's -9.3% drop. Building permits contracted four of the past five months, by -10.8%, to 1.229mu (saar); they are down -6.9% ytd. Multi-family permits declined for the fifth straight month, by a total of -22.2%, to 409,000 units (saar)—the lowest since March 2016. Single-family permits sank -6.1% last month, to 820,000 units (saar), after a two-month advance of 3.6%; these permits are down -6.5% ytd. Meanwhile, the National Association of Home Builders/Wells Fargo Housing Market Index (HMI) for September was unchanged at a solid 67. The HMI index measuring current sales conditions (to 74 from 73) rose one point, while sales expectations (74 from 72) advanced two points; the metric charting buyer traffic held steady at 49. "Despite rising affordability concerns, builders continue to report firm demand for housing, especially as millennials and other newcomers enter the market," said NAHB Chairman Randy Noel. "The recent decline in lumber prices from record-high levels earlier this summer is also welcome relief, although builders still need to manage construction costs to keep homes competitively priced."

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, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-775-6823

Copyright (c) Yardeni Research, Inc. Please read complete [copyright and hedge clause](#).