



MORNING BRIEFING

March 7, 2019

Getting Loopy

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

(1) Slicing and dicing the S&P 500 sectors. (2) Last year's tax cut boosted profit margins of some sectors more than others. (3) Winners emerging from Retail Apocalypse. (4) Shrinking can make a store stronger. (5) Going loopy over hyperloops.

Earnings: S&P 500 Sector Stories. Yesterday, Joe and I reviewed the Q4-2018 earnings data for the S&P 500. Today, let's slice and dice the earnings data for the S&P 500's 11 sectors.

To do so, we prefer using the I/B/E/S data by Refinitiv for operating earnings. Admittedly, this data set tends to be less conservative than the one compiled by S&P. That's because the former mostly reflects the adjusted operating numbers as reported by the companies and as widely followed by industry analysts. S&P prefers to have its own analysts determine what should be considered to be one-time extraordinary losses and gains.

Furthermore, Joe and I are big fans of weekly forward revenues/earnings/margin data, which matches up with the I/B/E/S quarterly series, as we showed in our analysis yesterday ([Fig. 1](#)). Without further ado, let's dive into the sectors ([Fig. 2](#) and [Fig. 3](#)):

(1) *Q4/Q4*. Here is the performance derby of the y/y earnings growth rates comparing Q4-2018 to Q4-2017: Energy (82.3%), Materials (41.0), Industrials (26.7), Health Care (15.1), Financials (15.0), S&P 500 (14.2), Information Technology (14.0), Consumer Discretionary (10.2), Real Estate (4.4), Consumer Staples (1.3), Utilities (-13.7), and Communication Services (-23.0).

(2) *2018/2017*. Here is the performance derby of the full-year growth rates comparing 2018 to 2017: Energy (103.7%), Financials (28.0), Materials (25.8), Information Technology (25.5), S&P 500 (22.5), Industrials (22.0), Health Care (15.4), Consumer Discretionary (14.9), Consumer Staples (10.6), Utilities (6.7), Real Estate (0.9), and Communication Services (-0.6).

It probably makes more sense to analyze the less volatile second set of growth rates, which provide clearer insight into the impact of the corporate tax cut implemented at the beginning of 2018. An even clearer picture emerges by looking at the profit margins of the sectors, also using four-quarter trailing earnings ([Fig. 4](#)).

(3) *Profit margins*. Here is the performance derby for the profit margins of the sectors during 2018 and 2017 (sorted from highest to lowest last year): Here is the performance derby for the profit margins of the sectors during 2018 and 2017 (sorted from highest to lowest last year): Real Estate (28.1%, 30.7%), Information Technology (22.8, 21.2), Financials (16.1, 13.7), Communication Services (15.5, 11.4), Utilities (12.3, 11.4), S&P 500 (12.1, 10.8), Health Care (10.8, 10.5), Industrials (9.7, 8.7), Materials (9.2, 8.3), Consumer Discretionary (7.5, 7.3), Consumer Staples (7.3, 6.5), and Energy (7.2,

4.3).

Consumer Discretionary: Winners Emerge. The Q4-2018 earnings of Kohl's and Target could have been awful. The government was shut down. The stock market was melting down. And overall retail sales dropped by 1.2% in December, according to government figures. Retail sales results were even worse—down 1.7%—excluding autos, gasoline, building materials and food services.

Instead, the two retailers reported Q4 earnings this week that topped expectations. They gained market share from retailers that were pushed into liquidation last year, including Toys “R” Us, Babies “R” Us, and Bon-Ton Stores. And Kohl's and Target benefitted from new technology, new brands, and innovative marketing efforts.

Kohl's shares rallied 7.3% on Tuesday and are up 19.3% since the market's Christmas Eve low. Likewise, Target shares rallied 4.6% on Tuesday and have gained 24.4% since the market low.

Since December's bottom, the S&P 500's Consumer Discretionary sector has been one of its top-performers, gaining 21.0% through Tuesday's close. Here's how the other S&P 500 sectors stack up: Industrials (24.9%), Information Technology (22.7), Energy (22.5), Consumer Discretionary (21.0), Communication Services (19.5), S&P 500 (18.7), Financials (18.1), Real Estate (16.5), Materials (15.7), Health Care (13.3), Consumer Staples (11.4), and Utilities (10.1) ([Table 1](#)).

Let's take a look at how these retailers are playing offense:

(1) *Perpetual innovation.* In the 3/15 [Morning Briefing](#), we highlighted the ways Kohl's is shaking up its business—reducing store size, emphasizing active wear, and striking a deal with Amazon to let its consumers drop off returns and pick up purchases at Kohl's stores. Those three changes continued to benefit the company in Q4 along with a number of new enhancements.

Kohl's benefitted from the competition's demise. Its strongest region in Q4 was the Midwest, helped by the closure of Bon-Ton stores. The company also enjoyed a “significant” increase in its toy business, helped by the introduction of LEGO and FAO Schwarz merchandise and the elimination of competition from Toys “R” Us.

Kohl's continues to shrink its square footage. It plans to close four underperforming stores in April out of its 1,159 store base, and open four new smaller-format stores later this year. It also plans to put Planet Fitness gyms in 10 of its store locations, which follows news last year that it would make space for 10 Aldi grocery stores.

“Ominichannel” may be an overused buzzword, but the ability of customers to buy online and pick up products in the store “drives traffic into our store and results in savings on shipping,” said CEO Michelle Gass on the company's 3/5 [conference call](#). Kohl's piloted an enhanced ship-from-store capability in 10 stores and plans to roll it out to another 135 stores to “further leverage stores in the peak digital demand.” It will also increase the number of Kohl's stores carrying Amazon products to 200 from 30 stores currently.

Active wear has been a bright spot since the company rolled it out in 2014. About 20% of stores have an expanded active wear section, and another 160 stores will have expanded sections this year. Kohl's is bringing in a number of new brands including Nine West shoes and a home collection from the Scott brothers of the popular television show *Property Brothers*; the company is also targeting Millennials with an “outfit bar” concept in 50 stores, highlighting brands popular with that demographic.

Kohl's calls for same-store sales of 0%-2% this year, with February's results expected to be at the low end of the range because of softness last month. Earnings guidance for this year is \$5.80-\$6.15 a share, including five cents per share of earnings from new lease accounting standards. Analysts were expecting earnings of \$5.75 a share this year.

Kohl's is the best-performing member of the S&P 500 Department stores industry, which also includes Macy's and Nordstrom. The industry's stock price index has risen only 3.7% since the market's December bottom ([Fig. 5](#)). The industry is expected to see tepid revenue growth of 1.1% this year and a 9.5% drop in earnings ([Fig. 6](#) and [Fig. 7](#)). The industry's forward P/E has fallen to 10.3, near the bottom of its 20-year range ([Fig. 8](#)).

(2) *Stores getting facelifts.* Target's same-store sales rose 5.3% in Q4 thanks to increased market share in toys and babies, remodeled stores, and a revamped fulfillment system that leans heavily on stores.

Over the last two years, more than 400 stores have been remodeled, and another 300 will get a facelift this year followed by 300 in 2020. Jackie has been to her local updated Target and attests to the nice job that was done making the store more modern and fashionable.

Target likes to say that it's the easiest place to shop. Customers can shop in store. They can order online and pick up their purchases that day in store. They can drive up and have purchases deposited in their trunks. And they can get purchases shipped to their homes on the same day they are ordered, thanks to Target's acquisition of Shipt.

"That's the foundation of our stores as hubs strategy," said COO John Mulligan in the company's [conference call](#). "A few years ago, when others said stores didn't matter, we doubled down on ours. We shared our plans to use them for both in-store experiences and digital fulfillment. And because of the investments we've made to put our stores at the center, Target has a delivery option to meet just about any guests' need for speed and to make shopping even easier."

By offering these varied delivery methods, Target lowered its average unit cost of fulfillment by 20%. "This year during our fourth quarter, stores fulfilled nearly three of every four orders, effectively doing the work of 14 fulfillment centers. That means we didn't have to spend nearly \$3 billion on new warehouses over the past few years to accommodate that growth. And with our store replenishment efforts that enable stores to fulfill a growing number of digital orders, we'll continue to have capacity over the next few years," said Mulligan.

Hyperloops: The Next New, New Thing? Jackie recently visited the West Coast and experienced LA's horrendous traffic first hand. Congestion is a problem in cities around the world, but a few companies are developing hyperloops in hopes of addressing the problem. In a call to developers everywhere, Elon Musk laid out his hyperloop transportation idea in a 2013 open-source [white paper](#). Capsules carrying people or freight would be levitated and propelled through tubes using magnets. The capsules would travel through large, low-pressure tubes at speeds that top 700 miles per hour. The tubes would have no windows because people would get sick looking outside while moving so quickly.

I asked Jackie to take a look at three of the companies that have embraced Musk's challenge: Virgin Hyperloop One, Hyperloop Transportation Technologies, and TransPod. Here's what she learned about some of the projects they're shepherding:

(1) *Virgin Hyperloop One.* Virgin Hyperloop is the furthest along when it comes to developing a hyperloop and raising money. The company did its first run on a 1,600-foot test track, called "DevLoop,"

outside of Las Vegas in May 2018. It has raised nearly \$295 million from investors including Richard Branson and DP World, which operates ports around the world and is owned by the UAE.

Virgin Hyperloop has the most traditional leadership. CEO Jay Walder previously headed New York's Metropolitan Transportation Authority and was managing director at Transport for London. Richard Branson served as chairman until he resigned in October, stating that the company needed a more hands-on chairman. However, his resignation may have been motivated by the death of Saudi journalist Jamal Khashoggi, because Branson also stepped down from a number of other projects and companies involved with Saudi Arabia, a Reuters 10/22 [article](#) reported. He was replaced by Bin Sulayem, chairman and CEO of DP World.

Virgin Hyperloop has a number of projects in their initial stages. The company is developing a hyperloop to transport cargo for a port in India operated by DP World, a 2/10 CNBC [article](#) reported, though no timing for deployment was given. And early last year, the Indian state of Maharashtra [announced](#) its intent to build a hyperloop between Pune, Navi Mumbai International Airport, and Mumbai.

In 2016, Virgin Hyperloop One announced its Global Challenge, a call for proposals to build hyperloops around the world. It received 2,600 applications and chose 10 routes, including four in the US: Dallas to Houston, Chicago to Pittsburgh, Miami to Orlando, and one route in and around Denver.

Now the company has a number of studies underway. Virgin Hyperloop and Colorado's Department of Transportation began a feasibility study in late 2017 for the Denver project, which the state estimates could cost \$24 billion. The Mid-Ohio Regional Planning Commission is spending \$2.5 million to study a rail or hyperloop between Pittsburgh-Columbus-Chicago. And Virgin Hyperloop, Black & Veatch, and the University of Missouri System announced a partnership to study a hyperloop route along I-70 in Missouri.

The Virgin Hyperloop plans to offer "on-demand solutions and no fixed schedule. Passengers will be able to depart as soon as they arrive. The system will be dynamic with the ability to deploy pods based on up-to-the-second data points that continually optimize departures and arrivals," explained a 5/22/18 company [press release](#).

(2) *Hyperloop Transportation Technologies* (HTT) has built a passenger capsule that can fit 28-40 people and is in the midst of building a 320-meter testing track in Toulouse, France. Testing will begin in April. The company, which plans commercial sites in Abu Dhabi and China, hopes its hyperloop will be ready for use in three years, a 2/26 CNBC [article](#) stated.

HTT plans to start construction in Abu Dhabi in Q3-2019. The China hyperloop will connect the southeastern city of Tongren with its airport, six miles away, and Mount Fanjing, a Unesco's World Natural Heritage site, 31 miles further. The Chinese project would cost more than \$1.5 billion to build, a 7/20 *WSJ* [article](#) reported.

HTT also has entered a joint venture with a German logistics and transportation company Hamburger Hafen und Logistik Aktiengesellschaft to bring a freight-moving hyperloop to the Port of Hamburg. "The project will begin with an initial study on connecting a cargo-based Hyperloop system from an HHLA container terminal to container yards located further inland, thereby expanding the port's capacity, while reducing congestion within the port and city area, and lowering the carbon footprint of the port," a 12/5 HTT [press release](#) stated.

HTT has raised \$42 million and has 50 full-time employees, according to a 2/18 *NYT* [article](#). Another

800 people around the world put in at least 10 hours a week on the project and are compensated with stock options. The company's CEO Dirk Ahlborn quit his job as a banker in Germany at 19, worked in Southern Europe, and then came to the US where he founded crowd-sourcing site JumpStarter. In 2013, JumpStarter reached out to SpaceX to feature Musk's Hyperloop concept on the JumpStartFund, per a 2013 [article](#) on Crowd Fund Insider. The rest is history.

(3) *TransPod*, a Canadian company, raised \$52 million in capital with which it [plans](#) to build a hyperloop test track this year and begin testing in 2020. It has preliminary agreements to build a six-mile test track for a route that ultimately will run the 180 miles between Calgary and Edmonton, Canada. It also plans a shorter track in France, according to the 2/18 *NYT* [article](#).

Challenges in building a hyperloop include raising huge sums of project financing and receiving the necessary rights of way and permits, particularly in the US. "Although there are advanced plans to create hyperloops in Missouri (St Louis to Kansas City in 31 minutes) and the Midwest (Pittsburgh to Chicago via Columbus in 30 minutes), the most likely to happen after the Pune to Mumbai line is in the UAE, where Dubai to Abu Dhabi in 12 minutes looks like a strong candidate for an early showpiece hyperloop," estimates a February [article](#) in TechRadar.

CALENDARS

US. Thurs: Productivity & Unit Labor Costs 1.6%/1.8%, Jobless Claims 223k, Challenger Job-Cut Report, Consumer Credit \$17.3b, EIA Natural Gas Report, Brainard. **Fri:** Nonfarm Payroll Employment Total, Private, and Manufacturing 178k/175k/10k, Unemployment Rate 3.9%, Average Hourly Earnings 0.3%/m/m/3.4%/y/y, Average Workweek 34.5hrs, Housing Starts & Building Permits 1.170mu/1.280mu, Baker-Hughes Rig Count, Powell. (Econoday estimates)

Global. Thurs: Eurozone GDP 0.2%q/q/1.2%/y/y, Japan GDP (annualized) 1.7%, Japan Leading & Coincident Indexes 96.0/98.9, Australia Retail Sales 0.3%, Mexico CPI 3.9% y/y, ECB Rate Decision 0.00%, ECB Marginal Lending Facility & Deposit Facility Rates 0.25%/-0.40%, Draghi. **Fri:** Germany Factory Orders 0.5%/m/m/-3.1%/y/y, Canada Net Change in Employment & Unemployment Rate - 2.5k/5.8%, Canada Housing Starts 203.5k, China Trade Balance \$27.2b. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): The Bull/Bear Ratio (BBR) remained at 2.57 this week after climbing seven of the prior eight weeks from 0.86—which was the lowest since mid-February 2016. The BBR's bullish sentiment component rose for the ninth straight week, by 23.0ppts, to a 21-week high of 52.9% from 29.9% (which was the fewest bulls since February 2016); bullish sentiment was as high as 61.8% in early October. Meanwhile, bearish sentiment has been bouncing in a narrow range between 20.4% and 21.5% the past seven weeks, and was near the bottom of that range this week, at 20.6%; it was 14.0ppts below its recent high of 34.6% nine weeks ago (which was the most bears since March 2016). The correction count fell for the fifth week, from 33.6% to 26.5%, the lowest since early October; it was at 41.1% 13 weeks ago (which was the highest percentage since late September 2015). The AAI Ratio advanced for the second week to 67.5% last week after slipping from 63.6% to 58.3% the prior week. Bullish sentiment rose for the second week, from 35.1% to 41.6%, while bearish sentiment slipped to 20.0% after rising the prior three weeks from 22.8% to 25.4%.

S&P 500 Earnings, Revenues, Valuation & Margins ([link](#)): Consensus S&P 500 forward revenues edged up 0.1% w/w, but forward earnings dropped 0.1%. Forward revenues is now down 1.2% from a record high in early January, and forward earnings is now 2.5% below its record high in early December. Analysts expect forward revenues growth of 5.3% and forward earnings growth of 6.0%, up

from week-earlier readings of 5.1% and 5.9%, respectively. Forward revenues growth is down 1.0ppt from a seven-year high of 6.3% in February 2018, but has improved from its lowest level since August 2016. Forward earnings growth is down 10.9ppts from a six-year high of 16.9% last February, but that's up from its lowest reading since April 2016. Prior to the passage of the Tax Cuts and Jobs Act (TCJA), forward revenues growth was 5.5% and forward earnings growth was 11.1%. Turning to the annual growth expectations, analysts expect revenues growth to slow from 8.5% in 2018 to 5.1% in 2019 and 5.6% in 2020. They're calling for earnings growth to slow sharply from 23.8% in 2018 to 4.3% in 2019 before improving to 11.3% in 2020. The forward profit margin remained steady w/w at a nine-month low of 12.1%, and is down 0.3ppt from a record high of 12.4% in mid-September. Still, that's up from 11.1% prior to the passage of the TCJA in December and compares to a 24-month low of 10.4% in March 2016. The S&P 500's forward P/E rose to a 21-week high of 16.5 from 16.4. That's up from 14.3 during December, which was the lowest reading since October 2013 and down 23% from the 16-year high of 18.6 at the market's valuation peak in late January. The S&P 500 price-to-sales ratio of 1.99 is up from 1.98 a week earlier and 1.75 during December, which was the lowest since November 2016 and down 19% from a record high of 2.16 in late January.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins ([link](#)): Consensus forward revenues rose w/w for five of the 11 sectors, but forward earnings was higher for just two sectors. Industrials was the only sector to have both measures rise w/w. Forward revenues and earnings are at or around record highs for 4/11 sectors: Consumer Discretionary, Health Care, Industrials, and Tech. Energy's forward earnings had about tripled from the 18-year low in April 2016 through early November, but has tumbled 25.9% since then. Forward P/S and P/E ratios are now well below their 2018 highs for all sectors, and had been at multi-year lows during December for five sectors: Energy, Financials, Industrials, Materials, and Tech. Energy's forward P/E of 17.8 is on the rise again as earnings deteriorate. Due to the TCJA, the profit margin rose y/y in 2018 for all sectors but Real Estate, but that sector's earnings includes gains from property sales, which typically are infrequent. The forward profit margin was at record highs during 2018 for 8/11 sectors, all but Energy, Health Care, and Real Estate. Since then, it has rolled over for all sectors except Financials and Utilities. The outlook for 2019 shows lower margins are now expected y/y for 6/11 sectors: Communication Services, Consumer Staples, Energy, Health Care, Materials, and Real Estate. During the latest week, the forward profit margin was steady for all 11 sectors, but nine sectors are down from their highs just a few months ago. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (22.2%, down from 23.0%), Financials (18.9, down from 19.2), Real Estate (15.2, down from 17.0), Communication Services (14.8, down from 15.4), Utilities (12.8, down from 13.0), S&P 500 (12.1, down from 12.4), Materials (10.6, down from 11.6), Health Care (10.5, down from 11.2), Industrials (at a record high of 10.3), Energy (6.7, down from 8.0), Consumer Discretionary (7.5, down from 8.3), and Consumer Staples (7.4, down from 7.7).

US ECONOMIC INDICATORS

ADP Employment ([link](#)): "The economy has throttled back and so too has job growth. The job slowdown is clearest in the retail and travel industries, and at smaller companies. Job gains are still strong, but they have likely seen their high watermark for this expansion," according to ADP's February report. Private industries added 183,000 to payrolls—slightly below expectations of a 189,000 advance—though there was a significant upward revision to December's (to 300,000 from 213,000) gain, while November's (249,000 from 263,000) was slightly lower, for a net gain of 73,000. This month, service-provided industries increased payrolls by 139,000, slowing from average monthly gains of 209,000 the previous two months, while goods-producing companies added an impressive 44,000 jobs, though below January's 93,000 surge—which was the biggest in the history of the series going back to 2001. The increase in service-providing companies was widespread, led by professional & business services (49,000), health care & social assistance (39,000), and financial activities (21,000). Within

goods-producing, construction (25,000) and manufacturing (17,000) companies continued to hire at a solid pace—adding 344,000 and 210,000, respectively, the past 12 months. Medium-sized companies (95,000,000) retained the number-one spot, while large companies (77,000) held on to the number-two spot—accelerating steadily from November's 7,000 gain. Meanwhile, small companies (12,000) remained in the cellar, posting its smallest gain since September 2017's 3,000 loss, as service-providing companies reduced payrolls by 4,000 last month.

Merchandise Trade ([link](#)): The real merchandise trade deficit in December posted its biggest gap in the history of the series going back to 1994, after narrowing in November for the first time in six months—suggesting trade was likely more of a drag on Q4 real GDP than first reported. December's deficit widened to a record -\$91.6 billion after narrowing from -\$89.0 billion in October to -\$81.6 billion in November. Real exports are down 3.7% since reaching a record high in May, while real imports rebounded 3.4% in December to a new record high. Dragging real exports lower were a 28.2% plunge in exports of foods, feeds & beverages during the final six months of 2018, and a 15.0% drop in auto exports from their recent peak in February. Real exports of capital goods (ex autos), consumer goods (ex autos), and industrial supplies & materials remained stalled at record highs. The rebound in real imports in December was widespread, with capital goods (ex autos), consumer goods (ex autos), industrial materials & supplies, and foods, feeds & beverages all posting impressive gains of 4.9%, 4.5%, 4.3%, and 3.3%, respectively; auto exports were flat at its record high.

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