



MORNING BRIEFING

April 11, 2019

Trouble Spots

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

(1) Manufacturing employment slipped in March—blip or inkling of trouble? (2) If Captains of Industry suffer, so do their supply-chain crews. (3) Are new cars getting too pricey in an Uber-enabled world? (4) GM and Ford both rerouting themselves operationally. (5) Drones finally deliver. (6) Alphabet-owned Wing beats Amazon to the skies.

Manufacturing: Wobbling Captains of Industry. With the S&P 500 within 1.8% of its all-time high and employment rebounding nicely in March, it's a good time to be on the lookout for trouble spots. It's not hard to find a few in the manufacturing sector.

Four of the nation's manufacturing giants—Boeing, Ford Motor, General Motors, and General Electric—are under pressure for disparate reasons. While US auto sales have held up well in recent months, auto manufacturers are spending more to develop electric and autonomous vehicles and facing slowing sales in China. Boeing has well-known problems with its grounded 737 jet, and GE is in the middle of a massive restructuring after a sharp decline in its power division. And did we mention the US's ongoing and potential trade wars with China and the European Union?

These problems haven't fazed investors. The S&P 500 Industrials sector, in which GE and Boeing reside, is among the best-performing of the 11 S&P 500 sectors ytd through Tuesday's close. Here's the performance derby: Information Technology (22.3%), Consumer Discretionary (18.4), Industrials (17.5), Energy (17.1), Real Estate (16.8), Communication Services (16.8), S&P 500 (14.8), Materials (13.5), Financials (10.7), Consumer Staples (10.3), Utilities (9.2), and Health Care (6.0) ([Fig. 1](#)).

Auto-related industries, which reside in the S&P 500 Consumer Discretionary sector, have outperformed as well. The S&P 500 Auto Manufacturers stock price index has jumped 17.9% ytd, along with Automotive Retail (17.9%) and Auto Parts & Equipment (35.4), which is the third-best-performing industry we cover. They all have beaten the S&P 500's 14.8% ytd return ([Fig. 2](#)).

Each of these manufacturers provides business for many smaller manufacturers. If the Captains of Industry get sick, their crew may get ill as well. The first possible sign of trouble may have arrived in last week's March employment report. While the overall economy added 196,000 jobs, the number of manufacturing employees fell by 6,000 from its peak of 12.827 million hit in February. The decline was driven by a loss of 7,000 jobs in durable goods manufacturing, marking the first time that segment had fallen since July 2017 ([Fig. 3](#)).

The drop in manufacturing employment could certainly be a blip, with the recent decline in interest rates about to bolster the economy and keep consumers spending on autos and housing. But just in case, I asked Jackie to look at some of the fundamental challenges facing the auto manufacturers. Here's what she discovered:

(1) *Pricey autos?* Sales of new vehicles have bounced around 17 million a year, and there are a number of headwinds that may prevent sales from heading higher ([Fig. 4](#)). In the near term, this includes lower-than-expected tax refunds (because Trump's tax cut boosted regular take-home pay), an onslaught of cars coming off lease, record average new car prices, and a slowdown in Chinese auto sales. Longer term, car sales may be hurt by the convenience and growing ubiquity of ride-sharing services.

US car sales may be held back by the rising cost of buying a new car. The amount of car loans outstanding was at record levels in Q4, as about 85% of car buyers take out a loan to fund their purchase ([Fig. 5](#)). Interest rates on new auto loans jumped to an average of 6.36% in March, up from 5.66% last year and 4.44% five years ago, according to a 4/2 Edmunds [press release](#). The average car price rose to \$36,534, up from \$31,924 five years ago. Over the past five years, the average financed portion of an auto purchase has increased, the average loan duration has lengthened, and the average monthly car payment has jumped 16% to \$554.

The higher price tag might push consumers into the used car market, where a record number of cars is coming off leases. A 12/18 Edmunds' [forecast](#) pegs new car sales at 16.9 million this year versus 17.2 million last year.

(2) *China cooling.* The once-hot Chinese auto market has cooled. Passenger-car sales fell 13.8% y/y in February to 1.48 million vehicles, marking the eighth consecutive month of declines, a 3/11 Reuters [article](#) reported. The only bright spot was the sale of new energy vehicles (electric cars), which were up 53.6% in February. (It's unclear whether the electric vehicle count is included in the passenger-car sales figure.)

"Market saturation in wealthy Chinese cities has coincided with a loss of confidence among consumers in smaller cities to dent demand. Meanwhile, both the market for ride-hailing services and the market for secondhand vehicles are growing, putting extra pressure on new-vehicle sales," a 3/11 WSJ [article](#) reported.

With US sales flat and Chinese sales tumbling, auto companies have been cutting costs to boost profits and free up funds for research. GM has been among the most aggressive. It sold its European division in 2017 and announced a restructuring late last year that included shutting five US factories and laying off 14,000 employees to save \$6 billion annually by 2020. GM CEO Mary Barra "is currently focused on cutting costs and improving cash flow to sustain strong results in the event the U.S. auto market cools, while still funneling money toward future bets on electric and self-driving vehicles," a 1/11 WSJ [article](#) stated. GM is expected to spend roughly \$1 billion on autonomous vehicle development in 2019. And it's expected to begin a commercial robot taxi service in the US this year.

Ford is also restructuring operations. It's exiting a Russian joint venture. In Europe, it's closing underused plants, slashing low-profit models, and laying off employees in Germany and the UK. In the US, Ford is investing more in its higher-profit trucks and SUVs and less in smaller, passenger cars. It's also increasing its commitment to electric vehicles in the US and introducing new models in China. The company plans to introduce autonomous cars in 2021, a 3/20 WSJ [article](#) explained.

(3) *Competition from ride-sharing.* That brings us to GM's and Ford's long-term dilemma: whether Lyft and Uber will depress demand for car ownership. In a HSBC survey, 18% of frequent Uber and Lyft users say they are less likely to buy or lease a car in the future, a 1/24 *Barron's* [article](#) reported. These killer apps and increasing urbanization led *Bloomberg Businessweek* to question in a 2/28 [article](#) whether the world has reached "peak car." The tipping point, the article contends, will occur around 2030 when automated cars hit the road, cutting 60% from the cost of taking a taxi and making car-sharing much cheaper than owning a car.

The S&P 500 Automobile Manufacturers stock price index has enjoyed a solid rally ytd, but it remains in a trading range dating back to 2011 ([Fig. 6](#)). There's little to inspire higher highs. Analysts forecast that revenue in 2019 will fall 1.1%, and next year it's expected to be flat ([Fig. 7](#)). Earnings are estimated to drop 3.0% this year and rise 2.2% in 2020 ([Fig. 8](#)). The industry's shares trade at 6.4 times forward earnings ([Fig. 9](#)). That's certainly low, but time will tell whether it's cheap.

Disruptive Technology: Drones Liftoff. After years of speculation, delivery by drone is taking flight. Wing, a startup owned by Alphabet, launched an air delivery service earlier this month in North Canberra, Australia. Flytrex has a mail delivery program in the Ukraine, a partnership with online marketplace Aha to make deliveries in Iceland, and a delivery program at a North Dakota golf course. Meanwhile, Amazon appears to still be testing a system it has under development, and a video of its theoretical blimp making drone deliveries had the Twittersverse tweeting. Let's have an airborne view of where drones are flying:

(1) *Wing's in the sky.* Using Wing's app, consumers can order goods from a number of local retailers and have them delivered by drone in minutes. Items available for delivery include coffee, over-the-counter pharmacy items, and food.

Wing has been testing the system in Australia for the past 18 months, making more than 3,000 deliveries. Its drone has fixed wings spanning less than 1.5 meters and rotors like a helicopter. The drone remains in the sky and drops a line carrying the item being delivered to the ground. Currently, pilots monitor the drones, but eventually Wing hopes the drones will be autonomous, according to the company's [website](#). The company aims to launch its service in Finland this spring.

Not everyone is pleased, however. Some residents in Bonython complained about the drones' high-pitched whirring noise. They contend that the drones' cameras record data and are an invasion of privacy. And lastly, they believe the drones repel wildlife, particularly birds, stated an 11/9 [article](#) on ABC News in Australia. Wing says it has quieter drones in development.

(2) *Bragging rights.* Wing has officially beat Amazon to the drone-delivery punch. Amazon is also working on a drone delivery system, called "Prime Air." A 2016 company [video](#) said a trial was occurring around Cambridge, England. The autonomous drones carry packages up to five pounds to make deliveries in under 30 minutes. They land on the ground and eject the packages before flying away.

Amazon also has a patent for an "airborne fulfillment center," basically a blimp that's a floating warehouse and uses drones for deliveries. News articles covered the theoretical blimp back in 2016. But the idea received renewed attention in recent weeks after a very realistic, computer-generated video surfaced showing an image of the theoretical Amazon blimp with many drones flying out of it to make deliveries. Created by a digital video artist in Japan, the Amazon blimp looks amazingly real. A 4/3 [article](#) on Digital Trends includes the video.

(3) *No need for ice.* Flytrex is working with Aha, an e-commerce company, to provide drone delivery of fast foods in about half of Iceland's capital. Within five years, they hope to have enough drones to deliver to the entire city, according to a 9/24 [article](#) in *Euro News*. Aha uses the drones for two to three deliveries per day.

The rules are strict: To receive goods in the backyard, a homeowner needs written permission from neighbors, the article states. The drones can operate from 11 am to 8 pm along 13 designated flight paths, from which they can deviate by up to 700 meters.

Flytrex also has an aerial mail delivery program in the Ukraine, a drone delivery program at King's Walk, a golf course in North Dakota, and is expanding a pilot in Holly Springs, North Carolina, where it worked last year with the state's Department of Transportation to test deliveries from restaurants to businesses.

There are numerous others working on drone delivery as well. "In May, Uber announced plans to deliver food by drone in San Diego, and local authorities cleared Alibaba's Ele.me to use drones to deliver meals along 17 routes in Shanghai's Jinshan Industrial Park. Microsoft will conduct undisclosed tests in Kansas ... and FedEx will develop a drone-powered aircraft inspection program in Tennessee," a 1/8 [article](#) on VentureBeat stated.

(4) *Is China ahead?* E-commerce company JD has launched a trial of delivering New Year's gifts by drone to rural villages in China. "The purpose of the drone program is to make deliveries to more remote areas of China more efficient," a JD spokesperson told DroneLife per a 1/16 [article](#). "Currently, it is costly, time consuming, and difficult to reach those areas, where order and population density are low. Right now, our drones are in daily operation in some rural areas in Jiangsu province and Shan'xi Province, now we've started to use drone delivery in the rural area in Sichuan province." Looks like birds are going to have to compete for air space.

CALENDARS

US. Thurs: PPI-FD Total, Core, Core Ex Trade Services 0.3%/0.2%/0.2%, Jobless Claims 201k, EIA Natural Gas Report, Bowman, Bullard, Clarida, Quarles, Kashkari. **Fri:** Consumer Sentiment Index 98.3, Import & Export Price Indexes 0.4%/0.2%, Baker-Hughes Rig Count. (DailyFX estimates)

Global. Thurs: Germany CPI 0.4%/m/m/1.3%/y/y, China CPI & PPI 2.3%/0.4% y/y, Mexico Industrial Production -0.5%. **Fri:** Eurozone Industrial Production -0.6%/m/m/-1.0%/y/y, China Trade Balance \$8.1 billion. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): The Bull/Bear Ratio (BBR) continued to rebound this week to its highest reading since mid-October 2016. The BBR had been in a volatile flat trend the past few weeks before jumping from 2.52 to 2.81 the past two weeks; it was at 0.86 14 weeks ago—which was the lowest since mid-February 2016. Bullish sentiment has increased 12 of the past 14 weeks, by 24.0ppts, from 29.9% (which was the fewest bulls since February 2016) to 53.9%, back up at its recent high recorded three weeks ago—which was the highest since early October. It's the eighth reading above 50.0%. Bearish sentiment dropped for a second week, to 19.2%—the lowest since mid-November—after bouncing in a range between 20.4% and 21.5% the prior 10 weeks. Meanwhile, the correction count ticked down for the second week, to 26.9%, after increasing for the first time in eight weeks during the final week of March to 27.4% from 25.5%—which was the lowest since early October. The AAI Ratio (to 55.3 from 55.0) was little changed last week, though down from 61.4% three weeks ago. Both bullish (35.0 from 33.2) and bearish (28.3 from 27.2) sentiment rose last week.

S&P 500 Earnings, Revenues, Valuation & Margins ([link](#)): Consensus S&P 500 forward revenues was at a record high in the latest week for a second week and the first time since early January, and forward earnings improved to 1.2% below its record high in early December. Analysts expect forward revenues growth of 5.6%, unchanged from a week earlier. However, forward earnings growth improved 0.6ppts w/w to an 11-week high of 6.7%. Forward revenues growth is down 0.7ppt from a seven-year high of 6.3% in February 2018, but is up from a 31-month low of 5.0% in mid-February. Forward

earnings growth is down 10.2ppts from a six-year high of 16.9% last February, but that's up from a 34-month low of 5.9% in late February. 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 8.4% in 2018 to 5.5% in 2019 and 5.5% in 2020. They're calling for earnings growth to slow sharply from 24.1% in 2018 to 3.5% in 2019 before improving to 11.4% in 2020. The forward profit margin remained steady w/w at a 12-month low of 12.0%, and is down 0.4ppt 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 has moved higher in just 12 of the past 14 weeks, and rose 0.2 points w/w to a six-month high of 16.7. 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 January 2018. The S&P 500 price-to-sales ratio rose w/w to 2.01 from 1.97, and is up from 1.75 during December. That was the lowest since November 2016, when the ratio was down 19% from its then-record high of 2.16 in January 2018.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins ([link](#)): Consensus forward earnings rose w/w for all 11 S&P 500 sectors, and forward revenues was higher for all but Financials. 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 is beginning to stabilize now after tumbling about 25% since early November. Forward P/S and P/E ratios are now well above their multi-year lows during December 2018 for all sectors, and are near or above their 2018 highs for four sectors: Communication Services, Real Estate, Tech, and Utilities. Due to the TCJA, the profit margin for 2018 was higher y/y for all sectors but Real Estate. The outlook for 2019 shows higher margins are expected y/y for just 4/11 sectors: Consumer Discretionary, Financials, Industrials, and Utilities. 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 moved lower for nearly all of the sectors, but early signs of a bottom are appearing. During the latest week, the forward profit margin rose 0.1ppt each for six sectors and was steady for the rest. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (22.1%, down from 23.0%), Financials (18.5, down from 19.2), Real Estate (15.4, down from 17.0), Communication Services (14.8, down from 15.4), Utilities (12.9, down from 13.0), S&P 500 (12.0, down from 12.4), Materials (10.5, down from 11.6), Health Care (10.4, down from 11.2), Industrials (10.2, down from a record high of 10.4 in mid-March), Energy (6.8, down from 8.0), Consumer Discretionary (7.6, down from 8.3), and Consumer Staples (7.4, down from 7.7).

US ECONOMIC INDICATORS

CPI ([link](#)): March's core CPI rate slowed to the Fed's target rate of 2.0% after 12 months above. Core prices fell to 2.0% y/y from 2.1% in February and 2.2% from November through January; it was once again below July's 2.4% rate—which was the fastest pace since September 2008. Here's a ranking of the core goods rates, lowest to highest: Apparel (-2.2% y/y), medical care commodities (-0.6), used cars & trucks (0.4), new vehicles (0.7), alcoholic beverages (1.5), tobacco & smoking products (5.4)—with only the last one surpassing the total core rate of 2.0%. Here's the same exercise for the core services rates: Airfares (-2.9), physicians' services (0.1), motor vehicle insurance (1.7), hospital services (1.8), owners' equivalent rent (3.3), rent of primary residence (3.7), and motor vehicle maintenance & repair (3.7)—with only the last one on an accelerating trend, though the rate for rent of primary residence reached an 11-month high. Core prices in March rose 0.1% for the second month, after gains of 0.2% in each of the prior five months. The three-month rate eased again, to 2.0% (saar), slowing from January's 2.6%—which was the highest since March 2018; it was at a 15-month low of 1.7% in October. The headline CPI rate ticked up to 1.9% from 1.5% in February—which was the lowest since September 2016; March's rate was a percentage point below its recent high of 2.9%

posted in both June and July.

GLOBAL ECONOMIC INDICATORS

UK GDP ([link](#)): Economic growth in the UK slowed in February, though the three-month rate held at January's pace. Monthly real GDP growth, which tends to be volatile, slowed to 0.2% in February after rebounding 0.5% in January and contracting 0.3% in December. In February, three of the major industry groups, construction (to 0.4% from 3.4%), services (0.1 to 0.3), and production (to 0.6% from 0.7%)—which includes manufacturing (0.9 from 1.1)—all slowed from January's pace, though production (and manufacturing) growth remained robust; activity in the agricultural sector sank 1.3% for the second month, after a 0.8% drop in December. On a rolling three-month basis, which is the ONS's preferred barometer for economic growth, GDP advanced 0.3% for the second month in February, after steadily easing from 0.8% in August—which was the strongest since early 2017—to 0.2% in December. Service industries, which account for about 80% of the private sector economy, continued to drive gains, climbing 0.4%—its 33rd straight three-month gain. Meanwhile, production expanded 0.2% in February, after contracting 0.5% in January and 1.9% during the three months through January. Manufacturing activity increased in February for the first time in five months, by 0.4%, boosted by manufacturers' stockpiling ahead of Brexit. Meanwhile, growth in both the construction and agricultural industries continued to contract, by 0.6% and 2.0%, respectively.

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