



MORNING BRIEFING

May 9, 2019

2020 Vision for Semis

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

(1) Investors look beyond the semi slump. (2) Hello 2020. (3) Who's afraid of a trade war? (4) Tech invades real estate. (5) Marriott loving Home Sweet Home. (6) How to sell your home for cash in 24 hours. (7) The We Company makes going to work cool and fun. (8) Free coffee and beer for everyone. (9) Traditional landlords upping their game.

Technology I: Semis Half Full. Semiconductor investors have written off this year and are pinning their hopes on 2020. That's the only way to explain the sharp rally in the industry's stocks despite the decline expected in revenues and earnings this year and the ongoing threat of a US/Chinese trade war.

The S&P 500 Semiconductors industry stock price index has climbed 22.7% ytd through Tuesday's close, and the S&P 500 Semiconductor Equipment stock price index has soared 34.6% ytd, making it the fourth-best-performing index that we follow ([Fig. 1](#) and [Fig. 2](#)). Let's take a look at what investors are ignoring and what they are looking forward to.

(1) *It's been a tough 2019.* The slump in semiconductor sales that began in November continued into March. Worldwide semiconductors sales fell 1.8% m/m and fell 13.0% y/y in March, according to a 4/29 Semiconductor Industry Association [press release](#) ([Fig. 3](#)). The industry's sales, using a three-month moving average, stood at \$42.1 billion at the peak and now are at \$32.3 billion.

(2) *Estimate cuts: fast and deep.* The sharp declines in industry sales weren't factored into analysts' estimates and resulted in many months of forecast slashing that may be showing signs of abating. Last August, analysts thought the S&P 500 Semiconductors industry would increase revenue in 2019 by 5.0%. But they have slashed those estimates in the ensuing months, and now the forecast is for revenue to decline 4.2% this year ([Fig. 4](#)). The same pattern holds for the industry's earnings estimates, which started dropping sharply in mid-2018 when they stood at 5.5%. Now analysts are calling for earnings to drop 11.5% this year ([Fig. 5](#)).

The story is similar in the S&P 500 Semiconductor Equipment industry. Revenue forecasts for 2019 have fallen sharply from the gains of 7.0% expected last May. Analysts are now calling for sales to drop 11.5% ([Fig. 6](#)). Estimates for 2019 earnings weren't spared either. They stood at 3.8% growth last May, but have since been cut to a 22.5% decline ([Fig. 7](#)).

(3) *Look to the future.* Analysts appear to be betting that the US/China trade war will be resolved because 2020 revenue and earnings forecasts for both industries have held up remarkably well. The S&P 500 Semiconductors industry is expected to grow revenue by to 6.6% next year, and earnings are projected to jump 9.2%.

Meanwhile, analysts forecast the S&P 500 Semiconductor Equipment industry will see a 7.2% increase in revenue and a 14.6% jump in earnings. The rollout of 5G technology next year and all the connected

devices it's expected to catalyze—in addition to the continued move to the cloud and adoption of electric cars—should be enough to keep manufacturers busy.

Technology II: Disrupting Bricks & Mortar. The world of real estate is undergoing massive disruption thanks to technological innovations. Last week's news that Marriott International planned to officially enter the home-rental business was just the latest development. Technology is affecting how homes are being sold, how businesses are renting space, and how strong the demand for retail and warehousing space is.

I asked Jackie to take a look at some of the disruption shaking up the normally slow-moving real estate industry. Here's what she found:

(1) *Marriott pulls the trigger.* Marriott announced last week its plan to make Tribute Homes, a pilot program to rent homes, a permanent offering renamed "Homes & Villas by Marriott International." Aimed squarely at Airbnb, Marriott plans to offer 2,000 premium and luxury homes in more than 100 locations in the US, Europe, the Caribbean, and Latin America.

We discussed Marriott's pilot last year in the 8/9 [Morning Briefing](#) after CEO Arne Sorenson mentioned it in the company's earnings conference call. At that time, the pilot involved only 200 homes in London, but it was expanded in October to include more in Paris, Rome, and Lisbon.

The program offers Marriott clients an entirely different experience than staying at one of the company's 1.3 million hotel rooms around the world. The company's ability to assure home renters that they'll receive Marriott-like quality and service when booking a home through the hotel company should be an advantage when competing against others in the home-rental industry. That said, Marriott is late to the game. Airbnb boasts 4.9 million rooms on its system, and Expedia Group's HomeAway offers 1.1 million, according to a 4/29 [WSJ article](#).

With an IPO expected next year, Airbnb has gotten so large that it can no longer be ignored by the hotel industry's traditional players. In addition, Airbnb has jumped into the hotel industry by acquiring Hotel Tonight, which offers others' hotel rooms at discounted prices and by investing in an Indian hotel-booking company.

Airbnb also "developed a unit aimed at corporate travelers that Airbnb says has attracted 400,000 companies, and it is leading a \$160 million funding round for Lyric, a luxury-rental startup that caters to business travelers by offering hotel services such as room cleaning and 24-hour customer support," the [WSJ article](#) explained.

Marriott's move into home rentals seems to be one part offense and one part defense.

(2) *Sell your home in 24 hours.* Disruption is tiptoeing into the retail end of real estate as well. iBuyers are using algorithms to make buying or selling homes fast and easy. Using an iBuyer is perfect, in theory, for the person who needs to buy or sell a home quickly or is looking for the certainty of having the proceeds from selling one home in order to buy another home.

Some of the players in this market include Zillow, Opendoor, Knock, and Offerpad. They all operate slightly differently. But in general, they will use an algorithm to make an offer on a home if it's in a region where they have operations. Right now, they tend to be clustered in fast-growing real estate markets, particularly those in the South in and around Atlanta, Dallas, Raleigh-Durham, Las Vegas, and Orlando.

iBuyers are looking for homes that meet certain specifications. Opendoor is willing to bid on homes in most markets that are between \$100,000 and \$500,000, that are built after 1960, and that sit on a maximum lot size of half an acre. It will also bid on townhomes and condos in certain markets.

At Opendoor, you type in your home's address, answer a few questions, and the company will make you an all-cash offer in 24 hours. (One skeptic said iBuyer offers are at least 5% below fair value, in a *6/5 Forbes* [post](#).) If you accept that offer, Opendoor will send an inspector to the house. Homeowners can make any required repairs or Opendoor will do the repairs and deduct the cost from the purchase price.

Once the deal is set, Opendoor sends a notary to your house to sign closing documents. The company takes a fee to cover charges involved with holding and reselling the house, like property taxes, utilities etc. Sellers are also responsible for closing costs. Opendoor's [website](#) explains that on a \$200,000 home, it might charge anywhere from 6%-13% in combined seller fees and closing costs.

That might seem high compared to the 5.5% it says most agents charge. But the agent's fee doesn't include staging and home-repair costs, seller concessions, or the costs of owning two homes simultaneously if you've bought a second home before selling the first. Those additional costs bring the traditional method of selling a home up to 10.5%, it claims.

It will be interesting to see whether this tech-driven model will hold up if the real estate market enters a downturn. Opendoor and Offerpad sold 743 homes (9.6% of their sales) to institutional investors between January 1 and November 29 last year, according to a [press release](#) from ATTOM Data Solutions. That's up from 293 homes (6.6%) in 2017 and 65 (3.9%) in 2016.

"These institutional investors may be turning to iBuyers as a source of inventory even as other sources of inventory such as foreclosures have largely dried up in recent years. Institutional investor purchases represented just 2.3 percent of all U.S. home sales so far in 2018, down from 2.9 percent in 2017 and down from a peak of 7.4 percent in 2012, according to the ATTOM analysis." Institutional buyers can disappear quickly if they fear a downturn is in the offing.

(3) *Working differently.* Love it or hate it, The We Company (formerly known as "WeWork") has shaken up the commercial real estate industry. With the mission of elevating the world's consciousness, The We Company started by taking out long-term leases in buildings that it renovated and subsequently leased to entrepreneurs and small businesses on a short-term basis. It offers its renters (called members) perks like free coffee and beer and hip décor in an effort to create a community-like atmosphere at work.

"In WeWork's buildings, the average square footage per person hovers around 50 square feet. This compares to 250 square feet for commercial offices industry-wide. Despite this small footprint, members pay an average of \$8,000 per year, with WeWork capturing a healthy 30–40% operating margin, according to the company. WeWork has touted frequent engagement with other co-working colleagues as a perk of working within a creative community, and less a reality of just how crowded its workplaces are," an excerpt from a 3/12/18 CB Insights [report](#).

The company's short-term space rentals and long-term lease commitments should raise concerns about The We Company's ability to ride out a market downturn. If short-term tenants walk, The We Company is still stuck paying its long-term leases. The concern only grows when you consider that the company's loss doubled to \$1.9 billion on revenue that doubled to \$1.8 billion, a 3/25 *WSJ* [article](#) explained. "WeWork executives said the losses are reflective of investments required to build out new offices, and that once locations are open and well-leased, they make far more money than the cost to

operate,” the article stated.

The We Company does, however, seem to be trying to reduce its risk. It started an Enterprise division, which leases large chunks of space—and sometimes even full buildings—to large corporations like IBM and Facebook. The company also manages a real estate fund that buys properties to lease to The We Company, which then leases the space to tenants. The We Company is also reducing risk by shifting from lease to co-management deals in which “landlords might pay for the renovation and buildout of offices and/or split membership profits 50/50,” the CB Insights report stated. And finally, the company is looking for longer-term commitments from its members, incentivizing brokers who refer clients who agree to commit for a year or more instead of month-to-month.

The We Company has filed to bring an initial public offering to market, the latest indication of its success. Traditional players have noticed. The Milstein real estate family is funding a 1.1 million square foot midtown Manhattan high rise that will mix below-market rentals to startups and above-market rentals to established companies that want to be in a “cool” space with entrepreneurial energy. The family, working with a company called simply “Company,” will take co-working to the next level, creating a tech campus, explains a 12/13 *Forbes* [article](#). Company will handpick and approve every occupant and offer tenants unique services, such as events with high-profile speakers. If nothing else The We Company is forcing landlords to up their game.

CALENDARS

US. Thurs: Jobless Claims 220k, Trade Balance -\$51.1b, PPI-FD Headline & Core 2.3%/2.5% y/y, EIA Natural Gas Report, Powell. **Fri:** Headline & Core CPI 2.1%/2.1% y/y, Monthly Budget \$160.0b, Baker-Hughes Rig Count, Williams, Brainard. (DailyFX estimates)

Global. Thurs: Japan Household Spending 1.6% y/y, Japan Consumer Confidence 40.3, China CPI & PPI 2.5%/0.6% y/y, Mexico CPI 4.4% y/y. **Fri:** Germany Trade Balance €18.9b, UK GDP 0.0% m/m/0.5% q/q/1.8% y/y, UK Headline & Manufacturing Industrial Production 0.4%/1.1% y/y, Canada Employment Change & Unemployment Rate 15k/5.8%, China New Yuan Loans ¥1200b, China Aggregate Financing ¥1650b, Mexico Industrial Production -0.4% y/y, RBA Statement on Monetary Policy, Coeure. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): The Bull/Bear Ratio (BBR) held above 3.00 this week, after jumping above last week for the first time since early October. The BBR fell for the first time in six weeks, ticking down to 3.12, after climbing from 2.52 to 3.17 the prior five weeks; it was at 0.86 at the end of last year—which was the lowest since mid-February 2016. Bullish sentiment fell for only the fourth time this year, slipping to 55.5% this week after climbing from 29.9% at the end of last year to 56.4% last week—which was a new high for this year. It’s the 12th consecutive reading above 50.0%. Meanwhile, bearish sentiment remained at 17.8% this week (the fewest bulls since mid-June 2018); it bounced in a range between 20.4% to 21.5% from late January through late March. For most of 2018, bearish sentiment was below 19.0%, including just 12.6% that January, when bulls hit their peak. At 26.7%, the correction count is up from 25.8% last week. Recent readings between 25% and 28% are well below the 39.3% count just before Christmas. (It was slightly higher at 41.1% just before last Thanksgiving.) The AAll Ratio increased to 64.6% last week after declining the prior two weeks from 66.4% to 62.4%. Bullish sentiment rose to 39.0% after falling from 40.3% to 33.5% the previous two weeks, while bearish sentiment edged up to 21.3% after edging down from 21.8% to 20.2% the prior week.

S&P 500 Earnings, Revenues, Valuation & Margins ([link](#)): Consensus S&P 500 forward revenues rose to a record high for the first time in five weeks, and forward earnings rose 0.8% w/w to 0.5% below its record high in early December. Analysts expect forward revenues growth of 5.7%, up 0.1ppt from a week earlier to a 16-week high. Forward earnings growth rose 0.6ppt to a 17-week high of 7.3%. Forward revenues growth is down 0.6ppt 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 9.6ppts 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 8.5% in 2018 to 5.1% in 2019 and 5.6% in 2020. They're calling for earnings growth to slow sharply from 24.1% in 2018 to 3.4% in 2019 before improving to 11.2% in 2020. The forward profit margin edged down 0.1ppt w/w to a 15-month low of 11.9%, and is down 0.5ppt 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 15 of the past 18 weeks, but edged down to 16.9 from an eight-month high of 17.0. 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 dropped 0.04 points w/w to 2.01 from a seven-month high of 2.05. That's still up from 1.75 during December when it was the lowest since November 2016, and down 19% from its then-record high of 2.16 in January 2018.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins ([link](#)): Consensus forward revenues and earnings rose w/w for ten of the 11 S&P 500 sectors. 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 move higher now after tumbling about 25% from November to February. 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 3/11 sectors: Consumer Discretionary, Financials, and Industrials. 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 fell 2.3ppts for Communication Services and 0.2ppt for Real Estate. Energy and Materials each rose 0.2ppt w/w, and three sectors rose 0.1ppt: Consumer Discretionary, Health Care, and Industrials. 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 (18.6, down from 19.2), Real Estate (15.3, down from 17.0), Utilities (12.9, down from 13.0), Communication Services (12.5, down from 15.4), S&P 500 (11.9, down from 12.4), Health Care (10.5, down from 11.2), Materials (10.4, down from 11.6), Industrials (10.2, down from a record high of 10.4 in mid-March), Consumer Discretionary (7.6, down from 8.3), Consumer Staples (7.3, down from 7.7), and Energy (7.2, down from 8.0).

S&P 500 Q1 Earnings Season Monitor ([link](#)): With 85% of the S&P 500 companies finished reporting revenues and earnings for Q1-2019, the y/y growth rates in revenues and earnings have slowed substantially from Q4. The revenue surprise metrics have weakened substantially, but earnings continue to beat forecasts. Of the 425 companies in the S&P 500 that have reported through mid-day Wednesday, 76% exceeded industry analysts' earnings estimates. Collectively, the reporters have averaged a y/y earnings gain of 3.3%, and exceeded forecasts by an average of 6.8%. On the revenue side, just 58% of companies beat their Q1 sales estimates so far, with results coming in 0.2% above forecast and 5.3% higher than a year earlier. Earnings growth is trailing revenue growth for the first time since H1-2016. Q1 earnings growth results are positive y/y for 65% of companies, vs a higher 73% at

the same point in Q4, and Q1 revenues have risen y/y for 68% vs a higher 75% during Q4. These figures are not likely to change markedly as more Q1-2019 results are reported in the coming weeks. Looking at earnings during the same point in the Q4-2018 reporting period, a lower percentage of companies (71%) in the S&P 500 had beaten consensus earnings estimates by a lower 3.6%, but earnings were up a higher 14.6% y/y. With respect to revenues at this point in the Q4 season, a higher 62% had exceeded revenue forecasts by a higher 0.8%, and sales rose a greater 7.3% y/y. The results so far for Q1 indicate a slowdown in revenue and earnings growth from Q4, but that comes as no surprise to investors. It now appears Q1-2018 will mark the 11th straight quarter of positive y/y earnings growth and the 12th for revenue growth. Looking at the Q1 results ex-Financials and Real Estate, the earnings surprise improves to 7.0% from 6.8% and growth falls to 2.5% from 3.3%. The ex-Financials and Real Estate revenue surprise of 0.2% and revenue growth of 5.1% both remain at the same rate as that with all sectors included.

GLOBAL ECONOMIC INDICATORS

Germany Industrial Production ([link](#)): Factory output in March increased for the third time in four months, though the Economic Ministry warned the outlook remained muted as the economy continued to be restrained by trade frictions and Brexit nerves. Germany's headline production—which includes construction—advanced 0.5% in March and 1.5% the past four months. Excluding construction, production climbed 0.4% in March after a two-month loss of 0.4%. Meanwhile, manufacturing output is drifting higher since reaching a low in November, climbing 0.8%. Within the main industrial groupings, only consumer durable goods production is showing signs of life, jumping 4.7% during the four months through March, climbing to its highest level since November 2017. Over the same four-month period, capital goods (1.1%) production showed a modest gain, while intermediate and consumer nondurable goods output were little changed. Data for April show IHS Markit's M-PMI (to 44.4 from 44.1) remained near March's 80-month low, posting the second-sharpest rate of contraction in 6.5 years, though did tick higher for the first time in nine months. According to the report, they won't have a "clear picture of whether the sector's downturn has bottomed out until the May flash results are published later this month."

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