



MORNING BRIEFING

September 5, 2019

Winners & Losers

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

(1) Stock market looks great ytd. Not so great y/y. (2) Despite record volumes, trucking industry tapping on the brakes as trade war hits spot freight market. (3) Lots of challenges for auto industry. (4) Tech stocks doing relatively well. (5) A bottom in world semiconductor sales? (6) The US capital markets remain wide open for business. (7) A big year for IPOs. (8) No credit crunch in the bond market.

Strategy: Keeping Score. Perspective is a funny thing. Much of what you see depends on where you stand, to take liberties with an old saying. One's opinion about the stock market's performance depends on when scorekeeping begins. Despite all the negative headlines, the S&P 500 is up 15.9% ytd through Tuesday's close, making this an above-average year. However, if the starting point is one year ago, the S&P 500's performance is a paltry 0.4%.

Consider the two performance derbies with different starting points:

(1) Looking at the rosier ytd returns, all but one of the S&P 500's sectors are in positive territory: Real Estate (27.7%), Information Technology (26.4), Consumer Discretionary (19.9), Utilities (19.7), Communication Services (18.8), S&P 500 (15.9), Industrials (15.7), Financials (11.3), Materials (10.9), Health Care (3.9), and Energy (-1.0) ([Fig. 1](#)).

(2) Conversely, the sectors' one-year returns aren't pretty, with conservative, interest-sensitive sectors performing the best and cyclical sectors taking it on the chin: Real Estate (20.1%), Utilities (18.2), Consumer Staples (12.0), Information Technology (5.4), Communication Services (3.8), S&P 500 (0.4), Consumer Discretionary (0.2), Materials (-2.4), Financials (-2.7), Industrials (-3.5), Health Care (-5.0), Energy (-24.7) ([Table 1](#)).

Since financial markets discount the future, perhaps the S&P 500's poor one-year returns anticipated the gloomy headlines we're seeing now, while the market's strength this year forecasts a brighter future. There's no way around it: The headlines about manufacturing, trucking, autos, farming, aerospace, and energy are gloomy. I asked Jackie to look at some of the news flow and see how related industries have reacted. Here's what she found:

(1) *Truckers hitting speed bumps.* The trucking market has loosened up after being extremely tight in recent years. The ATA Truck Tonnage Index rose to a new, record monthly high in July ([Fig. 2](#)). However, new trucks in the market, combined with less demand for transportation of goods to the ports for trade with China, have led to sharp price declines in the spot market, where last-minute transportation is booked. According to ISM's August M-PMI report, the new

export orders sub-index fell further below 50.0, contracting at its steepest pace since April 2009, falling to 43.3 from 48.1. The imports sub-index posted the biggest decline since December 2015, declining to 46.0 from 47.0 ([Fig. 3](#)).

In this weaker environment, trucking rates fell 0.1% y/y in July after a 27-month run of annual increases, according to an 8/29 *WSJ* [article](#), and prices on trucking's spot market dropped nearly 19% last month y/y. The PPI for trucking transportation of freight rose only 1.6% y/y during July, down from a recent peak of 8.2% during October 2018 ([Fig. 4](#)). The change in the business environment has pushed about 640 truckers out of business in H1-2019, up from 175 during the same period in 2018.

Given the trucking market's reversal, it's not surprising that new orders for some trucks have declined sharply. While median-weight and heavy truck sales rose to a cyclical high of 567,000 units (saar) during July, "[o]rders for heavy-duty models from the four largest truck makers in North America—Daimler Trucks North America LLC, Paccar Inc., Volvo Trucks USA and Navistar International Corp.—fell 80% in July from a year earlier," reported a 9/1 *WSJ* [article](#) quoting data from ACT Research ([Fig. 5](#)). June orders declined 69% y/y.

Despite the change in fortune, the S&P 500 Trucking stock price index is up 14.6% ytd ([Fig. 6](#)). Analysts forecast a deceleration in revenue growth from 19.8% last year to a still respectable 6.3% this year and 6.5% in 2020 ([Fig. 7](#)). Earnings this year are expected to fall 3.2%, but the comparison is a tough one given 2018's extremely strong 58.9% jump in earnings, which was boosted by Trump's corporate tax cut. In 2020, earnings are expected to grow a respectable 10.1% ([Fig. 8](#)). The industry's forward P/E has returned to a more normal 17.7, down from a peak of 25.5 in December 2017, but it's far from the recessionary levels of 6.5 and 8.2 seen in 2008 and 2012 ([Fig. 9](#)).

Because of the gloomy backdrop, the slightest sign of good news has the potential to send trucking shares higher. Navistar International reported on Wednesday fiscal Q3 earnings of \$1.56 a share, which soundly beat Wall Street's expectations for \$1.17 a share. Navistar stock, which was down 15.8% ytd through Tuesday's close, popped roughly 10% in trading Wednesday.

(2) *Autos coasting*. US auto sales peaked in September 2017 at 18.0mu (saar), and they've declined slightly ever since, with July's at 16.9mu ([Fig. 10](#)). Automakers are also being buffeted by slower auto sales in China, higher research costs to develop electric and self-driving cars, and new competition coming from electric cars and Chinese manufacturers. The latest in this tale of woe: The United Auto Workers (UAW) union said Tuesday that its members authorized UAW leaders to call a strike if a new labor deal with the manufacturers can't be reached. The current deal expires on 9/14.

Despite the industry's problems, the S&P 500 Automobile Manufacturing stock price index is up 13.8% ytd, the S&P 500 Automotive Retail stock price index has climbed 16.9%, and the S&P 500 Auto Parts & Equipment index tops them all with a 20.2% gain ([Fig. 11](#), [Fig. 12](#), and [Fig. 13](#)). Of the three industries, the stock price performance of the S&P 500 Automobile Manufacturers index is the most baffling because revenue is expected to decline 1.5% this

year and 0.5% in 2020 ([Fig. 14](#)). Earnings growth also is scant, with analysts forecasting a 1.8% increase this year and a 0.3% increase next year ([Fig. 15](#)).

Earnings in the S&P 500 Automotive Retail industry are expected to decelerate from 2018's banner result of 25.3% growth to still-strong rates of 14.9% in 2019 and 8.7% in 2020 ([Fig. 16](#)). While earnings in the Auto Parts & Equipment industry are forecast to drop 7.0% this year, they're expected to grow again in 2020 by 11.0% ([Fig. 17](#)). None of the three industries' 2020 earnings forecasts appear to anticipate a recession.

(3) *Tech marching on.* If a recession were imminent, you'd expect CIOs to be slashing their tech budgets. If they are, you'd never know it by looking at the ytd returns in the S&P 500 Information Technology sector. It's up 26.4% ytd, with the most impressive returns coming from Semiconductor Equipment (53.6%), Systems Software (30.2), and Technology Hardware, Storage & Peripherals (27.6) ([Fig. 18](#)).

Analysts are expecting the S&P 500 Information Technology sector's earnings growth to stall this year (0.5%) after a banner 2018 (26.3%). They're also calling for a return to more moderate earnings growth of 8.2% next year. Meanwhile, the Information Technology industry's forward P/E of 19.1 is expensive compared to where it's been during the recessionary years in the past two decades, but it's right on par with the P/E the sector has sported during the good times of the past 20 years ([Fig. 19](#)).

Two of the tech sector's top performers are the S&P 500 Semiconductors stock price index (up 16.7% ytd) and the Semiconductor Equipment index (53.6%). They both started to rally far before there was any good news in the headlines or in their earnings estimates. After many rounds of estimate cuts, the Semiconductors industry's earnings are expected to decline 13.9% in 2019 and increase only 0.7% next year ([Fig. 20](#)). Likewise, the Semiconductor Equipment industry's earnings, after many rounds of cuts, are expected to plummet 21.9% this year and gain only 4.8% in 2020 ([Fig. 21](#)).

Instead of earnings, investors may be pouncing on the positive inflection of the three-month moving average of worldwide semiconductor sales, which occurred in July for the second time in three months after falling for six consecutive months ([Fig. 22](#)). On a y/y basis, semi sales are still negative (-15.5%), but investors focused on the m/m data are looking at a half-full glass. As we said, it's all a matter of perspective.

Strategy II: Capital Markets Looking Healthy Too. Despite the stock market's volatility, companies are issuing bonds and stocks at a robust pace. While that can change at a moment's notice, for now the capital markets are open for business—yet another optimistic sign for the future. Let's take a look:

(1) *IPOs surging y/y.* In Q2, \$28.3 billion of US IPOs came to market, bringing the ytd total to \$42.5 billion, a 32% surge compared to last year, according to Dealogic [data](#) in the *WSJ*. And if the market continues to cooperate, the US IPO market may have its biggest year since 2014.

“As of August 29, there were 68 US IPOs publicly on file, 38 of which have submitted a new or

updated filing since June 1. Based on historical trends and both public and confidential IPO filings, we believe that 50-70 US IPOs could raise over \$15 billion between now and year end,” reported Renaissance Capital in its fall IPO [report](#). One thing slowing the market down: the disappearance of Chinese IPO filings. Last year in August, there were eight US IPOs filed by Chinese issuers.

(2) *Bond sales booming*. The market for high-yield bonds is open as well, with \$126.1 billion sold in Q2, bringing the ytd total up to \$200.3 billion, up 24% y/y. While the spread between the yield on high-yield corporate debt and 10-year Treasury notes has widened a bit, to 417bps from 353bps in mid-April, the absolute yield has fallen to 5.64%, near its lowest levels since November 2017 ([Fig. 23](#) and [Fig. 24](#)).

Investment-grade debt issuance is down slightly, 7%. But that is changing as corporate treasurers take advantage of the 10-year Treasury note’s recent rally. On Tuesday alone, US companies sold almost \$28 billion of bonds, the 9/3 *FT* [reported](#). Among the issuers was Deere, which sold 30-year bonds with a 2.877% yield, a record-low 30-year corporate bond yield. The previous record was a 3.197% 30-year bond sold by Walt Disney in 2016, a 9/3 *WSJ* [article](#) reported.

(3) *Big IPOs on the way*. IPOs have turned in a banner performance so far this year. The Renaissance IPO ETF is up 30.0% through Tuesday’s close, down from its 44% ytd performance in July but still sharply outperforming the broader stock markets. Those returns are even more impressive given the sharp ytd declines in two of its holdings: Uber Technologies and Lyft.

The strong IPO returns are good news for the deals waiting in the wings, including SmileDirect Club, which sells clear aligners directly to consumers. They eliminate the need to go to an orthodontist and reduce the cost of straightening one’s teeth by 60%, SmileDirect says. The company, which is unprofitable, plans to raise up to \$1.3 billion in its IPO.

SmileDirect and WeWork—which has a \$3 billion IPO pending—both will use an umbrella partnership corporation, or an “up-C,” when they go public. “The structure allows companies to sell shares through a public holding company that owns a stake in an underlying limited liability company, where certain company executives and early investors continue to hold their economic interests. Unlike WeWork, SmileDirectClub also said it would use a so-called tax receivable agreement granting LLC members 85% of the savings generated by an increase in the company’s tax basis,” an 8/16 *FT* [article](#) stated. Stay tuned to see whether investors push back against the deals’ added complexity.

Also expected to hit the market in September are Cloudflare, 10X Genomics, and Peloton Interactive. Cloudflare provides cloud-based networking and cybersecurity services. With plans to sell 35 million shares at \$10-\$12 each, it could raise north of \$400 million. 10X Genomics, which develops systems to analyze biological systems at the cellular level, plans to sell 9 million shares at \$31-\$35 each for proceeds that could top \$300 million. And Peloton Interactive has an IPO on deck that could raise \$500 million.

CALENDARS

US. Thurs: ADP Employment 140k, Jobless Claims 215k, Productivity & Unit Labor Costs 2.2%/2.4%, Factory Orders 0.8%, C-PMI & NM-PMI, EIA Natural Gas Storage, DOE Crude Oil Inventories. **Fri:** Payroll Employment Total, Private, and Manufacturing 160k/150k/5k, Unemployment Rate 3.7%, Average Hourly Earnings 0.3%_{m/m}/3.0%_{y/y}, Baker-Hughes Rig Count. (DailyFX estimates)

Global. Thurs: Germany Factory Orders -1.1%, Japan Household Spending, Guindos, Tenreiro. **Fri:** Eurozone GDP 0.2%_{q/q}/1.1%_{y/y}, Germany Industrial Production 0.3%, BOE/TNS Inflation Next 12 Months, Canada Employment Change & Unemployment Rate 20k/5.7%, Japan Leading & Coincident Indexes 93.2/100.7. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) was little changed this week, ticking up to 2.40 after sinking from 2.74 to 2.35 last week. Bullish sentiment edged up to 44.9% after tumbling 5.2ppts last week—from 49.1% to 43.9%—which was the fewest bulls since the 42.7% at the end of May. Meanwhile, the correction count inched down to 36.4% this week after jumping 4.4ppts last week—from 33.0% to 37.4%. There have been wide swings between the bullish and correction camps since early June. Meanwhile, bearish sentiment was unchanged at 18.7% this week, after three straight weeks near 18.0%. The AAll Ratio fell to 38.2% last week after climbing the prior two weeks from 31.0% to 40.1%. Bullish sentiment barely budged last week, at 26.1%, after rising the prior two weeks, from 21.7% to 26.6%; bearish sentiment rose to 42.2% after falling from 48.2% to 39.7% the previous two weeks.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): Consensus S&P 500 forward revenues and earnings edged up w/w and remain near their record highs. Analysts expect forward revenues growth of 5.4% and forward earnings growth of 7.9%, with the revenues measure up 0.1ppt from a week earlier. Forward revenues growth is now down 0.9ppt 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 9.0ppts from a six-year high of 16.9% last February but has improved steadily 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 4.4% in 2019 and 5.4% in 2020. They're calling for earnings growth to slow sharply from 24.0% in 2018 to 1.9% in 2019 before improving to 10.3% in 2020. The forward profit margin was steady w/w at 12.1% and is down just 0.3ppt from a record high of 12.4% in mid-September. That compares to 11.1% prior to the passage of the TCJA in December 2017 and a 24-month low of 10.4% in March 2016. Analysts are expecting the profit margin to drop 0.3ppt y/y from 12.0% in 2018 to 11.7% in 2019 before improving to 12.2% in 2020. The S&P 500's forward P/E edged down 0.2pt w/w to 16.6 from 16.8 and compares to an 18-month high of 17.4 in late July. 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. Similarly, the S&P 500 price-to-sales ratio eased w/w to 2.00 from 2.02 and compares to an 11-month high of 2.10 in

late July. That's 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 rose w/w for all 11 S&P 500 sectors last week, and forward earnings gained for 8/11 sectors. Forward revenues and earnings are at or around record highs for 4/11 sectors: Consumer Discretionary, Health Care, Industrials, and Tech. Forward P/S and P/E ratios have declined from recent multi-year or record highs for four sectors: Communication Services, Real Estate, Tech, and Utilities. However, all sectors remain well above their multi-year lows during December 2018. 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 one sector now: Financials. The forward profit margin rose to 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. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (21.7%, down from 23.0%), Financials (18.5, down from 19.2), Real Estate (15.9, down from 17.0), Communication Services (14.9, down from 15.4), Utilities (12.9, down from its record high of 13.0 in May), S&P 500 (12.1, down from 12.4), Health Care (10.5, down from 11.2), Industrials (10.3, down from its record high of 10.4 in early July), Materials (10.1, down from 11.6), Consumer Discretionary (7.5, down from 8.3), Consumer Staples (7.4, down from 7.7), and Energy (6.7, down from 8.0).

S&P 500 Q2 Earnings Season Monitor (*link*): With the Q2 earnings season essentially complete for the S&P 500 companies, here are the results compared to Q1. Actual revenues beat the consensus forecast by a higher amount (1.2% in Q2 vs 0.2% in Q1) as a similar percentage of companies reported a positive revenue surprise (57% vs 57%), but slightly fewer had positive y/y revenue growth (66% vs 68%). Earnings beat the consensus by a relatively strong, but smaller amount (6.1% vs 6.5%) as slightly fewer companies reported a positive earnings surprise (74% vs 76%), but a tad higher recorded positive y/y earnings growth (65% vs 64%). Looking at their growth rates, revenues rose 3.8% y/y in Q2, down from 4.9% in Q1 and the slowest rate since Q3-2016. Earnings rose just 1.7% y/y in Q2, down from 3.1% in Q1 and the slowest rate since the energy recession ended in Q2-2016. Ex-Boeing, Q2's y/y revenue growth improves 0.3ppt to 4.1% and y/y earnings growth improves 1.6ppts to 3.3%. Compared to 2018's stellar results, these readings for Q2 indicate continuation of a marked slowdown in revenue and earnings growth and a slight deterioration in profit margins. But that should come as no surprise to investors. Q2-2019 marked the 12th straight quarter of positive y/y earnings growth and the 13th of positive revenue growth. However, earnings growth trailed revenue growth during Q2-2019 for a second straight quarter and the first time since Q2-2016. That has happened just six times in the 42 quarters since the bull market started in Q1-2009.

US ECONOMIC INDICATORS

Merchandise Trade (*link*): The real merchandise trade deficit in July narrowed slightly for a second month, to -\$85.5 billion, after widening dramatically in May from -\$82.0 billion to -\$86.4 billion. It's too early to call trade's impact on real GDP this quarter, though July's -\$85.5 billion gap is in line with Q2's monthly average of -\$84.9 billion. Real exports of goods edged up 0.4% in July, while real imports of goods were flat. In July, real exports were mixed: Consumer

goods ex autos (9.2), autos (4.7), and capital goods ex autos (2.0) were all up, while exports of industrial supplies & materials (-4.7) and food (-3.5) were down. Meanwhile, a decline in real imports of capital goods ex autos (-2.6) offset gains in industrial materials & supplies (3.1), food (1.3), consumer goods ex autos (0.9), and autos (0.5). Taking a look at our trade deficit with China (in nominal terms), it has narrowed steadily from -\$420 billion at the end of last year to -\$397 billion during the 12 months through July. Over this comparable period, US exports to China fell by \$13 billion—from \$120 billion to 107 billion—while US imports from China fell at nearly triple that pace, from \$540 billion to \$503 billion.

Construction Spending ([link](#)): Construction spending lacks momentum. Overall spending edged up 0.1% in July, following revised declines of 0.7% in both June (from -1.3%) and May (-0.5); investment had increased 3.3% the first four months of the year. Still, spending remains at a relatively high level, within 3.3% of May 2018's record high. Spending on private construction fell for the third time in four months by a total of 1.4%, while public construction investment ticked up 0.4% in July after a two-month decline of 4.5%. Private residential investment remains weak, edging up 0.6%—its first monthly gain in eight months—led by a 1.4% jump in single-family homes; multi-family building contracted 1.1%, while home-improvement spending rose for the third month, by a total of 1.2%. Looking at residential construction ytd, multi-family building is up 0.5% but trending lower, while single-family building is down 2.5% and trending higher; home-improvement spending is flat. Private nonresidential construction fell 3.0% during the four months through July.

GLOBAL ECONOMIC INDICATORS

Eurozone Retail Sales ([link](#)): Retail sales took a step back in July after jumping to a new record high in June. Sales dipped 0.6% in July after increasing five of the prior six months by 5.6%. All three of the major sales categories weakened in July, but were up ytd: Non-food products excluding fuel (-1.0 m/m & 5.5% ytd), food, drinks & tobacco (-0.3 & 1.8), and auto fuel (0.0 & 1.0). Regionally, July sales were weak in three of the four major Eurozone economies for which data are available. German retail sales slumped 2.2% after rebounding 3.0% in June from May's 1.2% drop. Meanwhile, sales in both France and Spain were flat in July, with the former climbing two of the prior three months by 0.9% and the latter advancing 1.4% during the two months through June. On a y/y basis, total Eurozone sales rose 2.2%, with Spain (3.1% y/y), France (2.7), and Germany (1.7) all posting sales volumes higher than a year ago.

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