MORNING BRIEFING
September 12, 2019

No Shortage of Gluts

See the collection of the individual charts linked below.

(1) There's no business like show business. (2) Lots of streams for streamers. (3) Bingeing on "Grey's Anatomy." (4) Big bucks for content. (5) Fee wars. (6) Gloom in Frankfurt Auto Show. (7) Too many car companies as tech disrupts the auto market. (8) Comparing market-cap shares to earnings shares of S&P 500 sectors. (9) Robots running wild on college campuses.

Autos and Hollywood: Too Much Stuff. It's not often that we can compare the entertainment industry with the auto industry. But this week, it's possible because of Apple's presentation of its new offerings and the Frankfurt Auto Show. Both events made it clear that these industries are suffering from too much stuff.

Hollywood has too many hours of entertainment, and the auto industry has too many manufacturers selling too many cars. In addition, technology is roiling both industries: Streaming has forever changed the entertainment industry, and electric and autonomous vehicles are forcing auto-manufacturing incumbents to spend a lot of money to compete with the industry's upstarts. Altogether, these forceful trends are leading to deflationary pricing pressures. Below is Jackie's look at the industries' big events this week and what they tell us about Tinsel Town and Motor City:

(1) *Not enough hours in a day.* Jackie's daughter spent the second half of the summer binge-watching "Grey's Anatomy" on Netflix. Despite logging far too many hours of TV time, Cate only managed to watch five seasons of the medical drama. There are still 10 more seasons available for viewing! The experience made it abundantly clear that there are not enough hours in the day to watch even a small fraction of the video entertainment available for streaming. In addition to each season's new show offerings, incalculable hours of "reruns" are always just a click away.

(2) *Spending big bucks to compete*. All this content costs a lot to produce. Disney is expected to spend $16.4 billion on entertainment programming in 2019, a figure that excludes its budget for sports programing, a 1/29 article in *Variety* reported. Not far behind is Netflix's 2019 budget, forecast to be $15 billion on 301 original productions currently planned or in the works worldwide. Apple recently upped its production budget for 2019 to $6 billion from $1 billion, noted an 8/19 article on the Verge. And a 4/26 CNBC article estimated that Amazon is on pace to spend $7 billion this year. HBO Max is expected to reveal more about its offerings and spending at an October presentation.

The big dollars involved lead to questions about what kind of return these companies can earn on their investment. So perhaps it should be no surprise that activist investor Elliott Management Corp. revealed it took an equity stake in AT&T, noting the company's lack of focus in its entertainment division.

As a 9/10 *WSJ* article reported: Elliott "said in a letter to the company that it has 'failed to articulate a clear strategic rationale' for the $80 billion-plus Time Warner acquisition ... when it comes to direct-to-consumer streaming, there is a 'growing sense that AT&T doesn't have a plan,' given recent shifts in strategy. And it said the departure of top Time Warner executives leaves the company without necessary media expertise at a critical moment in the industry."

(3) *Let the pricing wars begin*. Despite a crowded field, Apple announced its entrance into the streaming wars with Apple TV+ and priced its service below everyone else's: $4.99 a month. The service is free for a year to those who buy certain Apple devices. Apple, which admittedly has less content today than the competition, undercut the pricing of Disney+ ($6.99 a month starting in December), Netflix's standard plan ($12.99), and AT&T's HBO Max (presumed to be slightly more than $14.99 when it launches later this year or early in 2020). Amazon's Prime Video is included in the Prime membership ($12.99 per month).

We've said it before (see our 3/28 *Morning Briefing*), and we'll say it again: There's a glut in TV programming and at some point subscription fatigue will set in.

(4) *Too many cars*. The auto industry also has tons of options from which consumers can pick. There are sedans, minivans, crossovers, and trucks. There are new manufacturers on the scene from South Korea and China. And now, thanks to the latest in technology, new manufacturers, including Tesla and Rivian, are offering up electric cars as an alternative to cars powered by the traditional combustion engine.

Traditional manufacturers are racing to catch up to their electric counterparts. At the Frankfurt Auto Show, Volkswagen is displaying its ID 3 electric vehicle, Porsche its Taycan electric sports car, and Mercedes-Benz its fully electric van. The Volkswagen ID 3's lowest end car will be priced at roughly $33,000, but it will only have 205 miles of range, a 9/9 article on The Verge reported. More expensive versions will be able to travel for up to 340 miles. The Porsche Taycan starts closer to $150,000, and the Mercedes van's price isn't yet available.

Despite his many crazy antics, Elon Musk has brought to market an affordable electric car that people want to drive. Tesla's Model 3 starts at $36,000, but typically costs more. And so far, it has proven itself a worthy new competitor in an already crowded field.

(5) *Gloom in Frankfurt.* The latest signs of the global auto industry's malaise are on display at the Frankfurt Auto Show, which has fewer exhibitors and less exhibition space. "[E]xhibition space had been cut from around 200,000 square meters in 2017, to around 168,000 this year…The number of exhibitors has shrunk to around 800 this year, from 994 in 2017. Fiat, Volvo, Mitsubishi, Nissan, Subaru, Chevrolet, Cadillac, and Aston Martin will skip the show and only five exhibition halls will have new cars, instead of eight," according to a 9/2 Reuters article.

Back in the US, Moody's Investors Service on Tuesday cut Ford Motor's bond rating to Ba1 (making it a "junk" bond), down from Baa3 (investment grade). The agency noted the company's "weak cash generation and a years-long restructuring plan that the auto maker is undertaking just as the car market softens globally," a 9/9 *WSJ* article reported. However, it added that the company has a "sound balance sheet and liquidity position."

Both S&P Global Ratings and Fitch Ratings still consider Ford debt two notches higher than junk, so Ford's debt will remain in the Bloomberg Barclays investment-grade corporate bond index.

(6) *Prices only inching higher.* According to government data, new vehicle prices are climbing much slower than prices in the overall economy. New vehicles prices (which includes both cars and trucks) in the Consumer Price Index (CPI) rose 0.3% y/y in July, which is far below the overall CPI's 1.8% y/y

increase in July (*Fig. 1*).

(7) *Data dump.* The S&P 500 Automobile Manufacturing index is up a surprisingly strong 20.3% ytd through Tuesday's close (*Fig. 2*). The industry has rallied even though its revenue is expected to fall 1.6% this year and 0.5% in 2020 (*Fig. 3*). Expected earnings growth doesn't look much better, but it is positive for now: 1.5% in 2019 and 1.0% in 2020 (*Fig. 4*). The industry's forward P/E, at a recent 6.2, has been extremely low for the past four years, which often means a cyclical industry is at its earnings peak (*Fig. 5*).

Disney and Netflix are members of the S&P 500 Movies & Entertainment stock price index, which has risen 16.3% ytd through Tuesday's close (*Fig. 6*). The industry's revenue is expected to grow a robust 16.5% this year and 18.0% in 2020 (*Fig. 7*). Earnings, however, are forecast to fall sharply in 2019 (-14.0%), only to rebound sharply and grow 10.4% in 2020 (*Fig. 8*). Despite the earnings volatility, the industry's forward P/E has held near its recent highs at 27.0 (*Fig. 9*).

Strategy: Looking for Bubbles. In theory**,** a sector's market capitalization as a percentage of the S&P 500's should be close to the percentage of earnings that sector kicks into the broader index. When market-cap and earnings contributions differ dramatically, it's often the sign of a valuation-based buying—or selling—opportunity. Perhaps the most famous example of this was the 2000 tech bubble, when the S&P 500 Information Technology sector represented 33.7% of the S&P 500's market cap but only 16.3% of its earnings.

Today's divergences are much smaller than that extreme case, but they're interesting, nonetheless. Information Technology is still the S&P 500 sector with the market capitalization that most exceeds its earnings. The sector contributes 22.1% of the S&P 500's market capitalization, but its earnings represent only 19.1% of the S&P 500's earnings (*Fig. 10*). Not far behind are the Consumer Discretionary sector, which contributes 10.2% of the S&P 500's market cap but only 8.1% of its earnings, and Real Estate with a 3.3% capitalization and a 1.2% earnings share (*Fig. 11* and *Fig. 12*).

On the other side of the coin are the sectors with higher earnings shares than market-cap shares. Financials is the most undervalued sector by this metric, with a market cap that contributes 12.7% of the S&P 500's but earnings that represent 18.5% of the broader index's (*Fig. 13*). Looking back over the last 25 years or so, financials have typically contributed more in earnings than capitalization. More unusual is the Industrials sector, with a 9.2% market-cap share and a 10.1% earnings share (*Fig. 14*). The Health Care sector has a 13.8% market-cap and a 15.9% earnings contribution. Before 2009, that sector's market-cap share typically exceeded its earnings contribution.

The differences between the market-cap and earnings shares in the remaining S&P 500 sectors are minimal. Here's the full list of the sectors' market-cap and earnings shares: Information Technology (22.1, 19.1), Health Care (13.8, 15.9), Financials (12.7, 18.5), Communication Services (10.5, 10.0), Consumer Discretionary (10.2, 8.1), Industrials (9.2, 10.1), Consumer Staples (7.7, 6.4), Energy (4.4, 5.1), Utilities (3.5, 3.0), Real Estate (3.3, 1.2), and Materials (2.7, 2.7) (*Fig. 15*).

Disruptive Technologies: Robots Attending College. Looks like the younger set is quickly embracing robot delivery. Starship Technologies, which just raised $40 million, plans to roll out its delivery robots to 100 universities within the next two years. Each university will have 25-50 robots making deliveries. The company already has robots rolling along the sidewalks of University of Pittsburgh, Purdue University, Northern Arizona University, and George Mason University.

Starship deploys an app that customers can use to order food from meal plan service providers and restaurants. Deliveries are made anywhere on campus and cost $1.99 (less than most tips!). When the robot arrives at the delivery location, it sends a text message to the recipient that it has arrived along with a link that will unlock the robot. The robot can carry up to 20 pounds, or about three shopping bags filled with food, and it can cross the street, maneuver curbs, and operate in the dark, rain and snow, according to a 1/22 article in Mashable. The robot looks a lot like Scout, Amazon's sidewalk-driving delivery robot that we discussed in the 8/8 *Morning Briefing*.

The Starship robot does have an Achilles' Heel: It can't climb stairs. ANYbotics, a Swiss company, has conquered that mountain with a dog-like delivery robot. It has four "legs," weighs about 80 pounds, and climbs stairs and other obstacles. It can even reach up to ring a doorbell or an elevator button. It can drop your parcel at a doorstep or place it in a parcel box.

For CES earlier this year, ANYbotics and Continental partnered up to create a vision of a driverless shuttle that carries many robot dogs that are set loose to deliver packages. Take a look at this cool video on Mashable. It gives a whole new meaning to the phrase: "Drop it." The company also has developed a four-legged robot that can carry out inspections in industrial settings and other areas where humans don't want to go, like sewers and offshore drilling platforms.

Here's the company's promotional video showing how the robot operates in an industrial setting. An 8/22 IEEE Spectrum article describes ANYbotics' robot: "It can move at 1 meter per second, manage 20-degree slopes and 45-degree stairs, cross 25-centimeter gaps, and squeeze through passages just 60 centimeters wide. It's packed with cameras and 3D sensors, including a lidar for 3D mapping and simultaneous localization and mapping (SLAM). All these sensors (along with the vast volume of gait research that's been done with ANYmal) make this one of the most reliably autonomous quadrupeds out there, with real-time motion planning and obstacle avoidance." Wonder if our pooches should get nervous about being replaced?

CALENDARS

US. Thurs: Headline & Core CPI 1.7%/2.3% y/y, Jobless Claims, EIA Natural Gas Storage. **Fri:** Retail Sales Total, Ex Autos, Ex Autos & Gas, and Control Group 0.2%/0.1%/0.3%/0.3%, Business Inventories 0.3%, Consumer Sentiment Total, Current Situation, and Expectations 90.8/107.8/85.2, Import Prices Total and Ex Petroleum -0.5%/-0.1%, Baker-Hughes Rig Count. (DailyFX estimates)

Global. Thurs: Eurozone Industrial Production 0.1%m/m/-1.3%y/y, Germany CPI -0.2%m/m/1.4% y/y, ECB Rate Decision 0.00%, ECB Marginal Lending Facility & Deposit Facility Rates 0.25%/-0.50%. **Fri:** Eurozone Trade Balance €17.5b, Japan Industrial Production. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) climbed for the second week this week to 2.79 after falling from 2.74 to 2.35 two weeks ago. Bullish sentiment rose 6.1ppts—to 50.0% from 43.9%—over the two-week period, as the correction count fell 5.3ppts, to 32.1% from 37.4%. It was the most bulls since the 57.2% recorded during the final week of July. There have been wide swings between the bullish and correction camps since early June. Meanwhile, bearish sentiment slipped to 17.9% this week—fluctuating in a narrow band from 17.9% to 18.7% the past six weeks. The AAII Ratio climbed to 42.0% last week after falling from 40.1% to 38.2% the previous week, as bullish sentiment rose from 26.1% to 28.6% while bearish sentiment fell from 42.2% to 39.5%.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): Consensus S&P 500 forward revenues and earnings rose w/w to new record highs. Analysts expect forward revenues growth of 5.4% and forward earnings growth of 8.6%, with the earnings measure up 0.7ppt 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 8.3ppts 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 5.3% in 2020. They're calling for earnings growth to slow sharply from 24.0% in 2018 to 1.9% in 2019 before improving to 10.2% 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 up 0.1pt w/w to 16.7 from 16.6 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 rose w/w to 2.02 from 2.00 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 and earnings rose w/w for all 11 S&P 500 sectors last week. 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. During the latest week, they rose 0.1ppt for seven sectors and were at record highs for two sectors. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (21.8%, down from 23.0%), Financials (18.6, down from 19.2), Real Estate (15.9, down from 17.0), Communication Services (15.0, down from 15.4), Utilities (13.0, record high), S&P 500 (12.1, down from 12.4), Health Care (10.5, down from 11.2), Industrials (10.4, record high), Materials (10.2, down from 11.6), Consumer Discretionary (7.5, down from 8.3), Consumer Staples (7.4, down from 7.7), and Energy (6.8, down from 8.0).

US ECONOMIC INDICATORS

PPI (*link*): The Producer Price Index for final demand ticked up 0.1% in August after gains of 0.2% and 0.1% the prior two months, with the yearly rate edging up to 1.8% y/y from 1.7%—which was the lowest rate since January 2017. Prices for final demand goods sank 0.5% last month after a 0.4% gain and a 0.4% loss the prior two months—with nearly two-thirds of August's decline traced to a 6.6% drop in the price of gasoline. The yearly inflation rate for final demand goods (-0.1% y/y) hovered around zero for the third month; it was at 4.4% last July. Meanwhile, prices for final demand services rose 0.3% after ticking down 0.1% in July—with a 6.4% increase in guestroom rentals a major factor in August's rise. The services rate climbed to 2.7% y/y, matching its high for this year, up from 2.3% in June, which matched its low for the year. Meanwhile, there's no deflation in the pipeline: Intermediate goods prices fell 2.8% y/y in August—a three-year low—while crude prices were 7.8% below a year ago, narrowing from double-digit losses the prior two months.

GLOBAL ECONOMIC INDICATORS

France Industrial Production (*link*): Output in July moved slightly higher after posting is largest decline since January 2018 in June. Headline production, which excludes construction, has been fairly volatile so far this year. Output edged up 0.3% in July after a 2.3% slide in June, which followed a two-month increase of 2.5% during the two months through May—squeaking out a 0.7% ytd gain. Manufacturing output climbed 0.3% in July, after falling three of the prior four months, with the ytd gain virtually flat. Looking at the main industrial groupings ytd, it's a mixed bag, led by energy (4.0% ytd), with consumer durable (1.4) and capital (1.3) goods production also in the black; intermediate goods production fell 1.0% ytd, while consumer nondurable goods output was basically flat. France's M-PMI moved back above 50.0 in August, to 51.1, after falling from 51.9 in June to 49.7 in July, a promising sign. According to the report, French goods producers recorded rebounds in both output and new orders, pointing to "a resilient French manufacturing sector at a time when their European counterparts are struggling."

Italy Industrial Production (*link*): Production remains in a volatile flat trend around recent lows. Italy's headline series, which excludes construction, sank a larger-than-expected 0.7% in July after losing 0.3% in June. Over the past 12 months, total output is down 0.7% y/y, while manufacturing production is 1.3% lower. Of the main industrial groupings, only consumer durable goods (6.0% y/y) and energy (5.8) output are rising on a y/y basis. Capital (-3.0) and intermediate (-2.0) goods output are in the red, while consumer nondurable goods production is flat with a year ago. IHS Market reports Italy's August M-PMI (to 48.7 from 48.5) was below 50.0—the delineation between expansion and contraction—for the 11th consecutive month, with output and new orders decreasing for the 13th month running. Meanwhile, business expectations remained in positive territory, although overall sentiment dipped to its lowest in four months.

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