



MORNING BRIEFING

September 26, 2019

The Utility of Utilities

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

(1) Political storms send investors running for cover. (2) Utilities fill the bill. (3) Safety in dividend and earnings numbers. (4) Investors take defensive refuge in other fast-growing and income-providing S&P 500 sectors too. (5) Onward and upward for technology innovation. (6) Prepare to be disrupted: the latest in quantum computing, robots, drones, and high-tech tunneling. (7) Are used cars the new new cars? (8) CarMax: not your father's Oldsmobile dealer.

Strategy: Lots of Winners. After days like Tuesday, it's easy to understand why "safety sectors"—perceived as less risky than average—have been in vogue. President Trump's speech to the UN dashed investors' hopes for a quick trade agreement. He bluntly described how the Chinese steal US technology and benefit from unfair trade practices, and later in the speech painted US tech companies as enemies of democracy. The day ended with House Speaker Nancy Pelosi (D-CA) announcing that the House of Representatives is beginning a formal impeachment inquiry into President Trump. Another banner day in US politics.

Safety sectors ruled the day on Tuesday, continuing the outperformance that has accelerated since late summer. Here's the performance derby for the S&P 500 sectors from 8/1 through Tuesday's close: Utilities (7.5%), Real Estate (4.7), Consumer Staples (2.4), Industrials (1.3), Financials (1.0), S&P 500 (0.4), Consumer Discretionary (-0.3), Communication Services (-0.4), Health Care (-0.5), Materials (-0.5), Information Technology (-0.8), and Energy (-1.4) ([Table 1](#)). Let's dive deeper into the market's movements:

(1) *Utilities stocks hitting records.* Ironically, the S&P 500 Utilities stock price index is at a record high even though its market-capitalization share of the S&P 500 is at an all-time low ([Fig. 1](#) and [Fig. 2](#)). The industry's stock performance has been helped by P/E multiple expansion. The S&P 500 Utilities trade at a forward multiple of 19.8, 3.4pts higher than one year ago ([Fig. 3](#)). But that's far below the 55.6 "P/E" of the 10-year Treasury note ([Fig. 4](#)).

(2) *Utilities' dividends attractive.* Utilities also offer a nice dividend yield, relative to other S&P 500 sectors'. A sluggish global economy combined with low inflation could make dividend payers attractive for some time. Here's are the dividend yields offered by the various S&P 500 sectors: Energy (3.47%), Real Estate (3.16), Utilities (3.11), Consumer Staples (2.87), Communication Services (2.32), Financials (2.11), Materials (1.98), Industrials (1.94), S&P 500 (1.92), Health Care (1.71), Information Technology (1.38), and Consumer Discretionary (1.30) ([Fig. 5](#)).

(3) *Utilities seeing strong relative earnings this year...* Investors' love affair with Utilities has some foundation in fundamentals this year. Analysts are expecting the sector to grow earnings moderately, by 4.2%, in 2019. That makes Utilities the fourth-fastest-growing among the S&P 500's 11 sectors. Here are the S&P 500 sectors' expected 2019 earnings growth rates: Financials (9.2%), Health Care (7.4), Consumer Discretionary (5.2), Utilities (4.2), Communications Services (2.6), S&P 500 (2.0),

Consumer Staples (1.1), Information Technology (0.5), Industrials (0.4), Real Estate (-0.1), Energy (-20.0), and Materials (-21.8) ([Fig. 6](#)).

(4) ...*But there's more earnings growth elsewhere in 2020.* However, investors buying Utilities today may be fighting yesterday's war. Looking forward to 2020, traditional growth sectors are forecast to have much faster earnings growth than Utilities and other safety sectors. Here are the S&P 500's sectors' expected earnings growth rates in 2020: Energy (28.8%), Industrials (17.2), Materials (15.6), Communications Services (12.4), Consumer Discretionary (12.0), S&P 500 (10.1), Health Care (9.7), Information Technology (8.0), Consumer Staples (7.1), Financials (5.2), Utilities (5.1), and Real Estate (-10.9).

Perhaps that explains why both high-growth and defensive names are having a banner year. Investors willing to look ahead can justify buying S&P 500 Tech, Communications, and Consumer Discretionary sectors because of their faster earnings growth, while defensive investors or those looking for income can turn to Utilities, Real Estate, and Staples.

For a change, almost every sector is a winner on a ytd performance basis through Tuesday's close: Information Technology (28.6%), Real Estate (26.4), Utilities (22.1), Communication Services (20.8), Consumer Discretionary (20.2), Industrials (20.1), Consumer Staples (19.3), S&P 500 (18.3), Financials (17.0), Materials (14.2), Energy (5.0), and Health Care (4.9) ([Fig. 7](#)).

Disruptive Technologies: Updates. Technology stands still for no one. Here are some of the latest developments in four areas we've touched on in the past: quantum computing, robots, drones, and high-tech tunneling. I asked Jackie for a quick update:

(1) *Google claims quantum supremacy.* Google claims that its quantum computer is more powerful than the most powerful classical computer. This claim of "quantum supremacy" was made in a research paper temporarily posted on a NASA website, a 9/20 *FT* [article](#) stated.

The paper claimed that the Google quantum computer could perform a calculation in three minutes and 20 seconds, beating the 10,000 years that the same calculation would take the fastest classical computer, dubbed "Summit." Google's 53-qubit computer was asked to prove "that a random-number generator was truly random. Though that job has little practical application, the Google researchers said that 'other initial uses for this computational capability' included machine learning, materials science and chemistry," the *FT* reported.

Google, which declined to comment in the *FT*'s story, predicted in the report that the power of quantum computers would increase at a "double exponential rate" compared to the exponential rate laid out in Moore's Law, which has described the rate of improvement in silicon chips and classical computers. For a primer on quantum computing, check out our 7/11/18 [Morning Briefing](#).

(2) *More on high-tech deliveries.* On its earnings [conference call](#) last week, FedEx mentioned that Roxo, its delivery robot, is being tested in three markets: Memphis, Tennessee; Plano, Texas; and Manchester, New Hampshire. "Roxo [is] preparing to change the way on-demand e-commerce shipments make it to customers' doorsteps," said Brie Carere, FedEx's chief marketing and communications officer.

Roxo has conquered the challenges of stoops and curbs because its power base "is modeled after the standing, stair-climbing wheelchair invented by Dean Kamen of DEKA Development and Research, more than 20 years ago. Now, higher volume production of the base could help lower the cost and make the wheelchair more accessible for the disabled," an 8/7 MSN [article](#) reported. Here's a

promotional FedEx [video](#) of Roxo.

Roxo faces competition from drones. FedEx, Walgreens, and Sugar Magnolia are working with Wing, the drone delivery service company that began life at Alphabet. Starting next month, they plan to use Wing's drones to deliver health care products, food, and other items in Christiansburg, Virginia, according to a 9/19 [article](#) on The Verge. Wing has been certified as a commercial air carrier by the Federal Aviation Administration, which allows its drones to make deliveries even when they are not within the drone operator's line of sight.

Here are the details, courtesy of a 9/19 CNET [article](#): "The drones will take off from and land at a nearby service center. They'll fly about 100 to 200 feet in the air. When the drone is ready to drop off a package, it'll hover at about 23 feet and lower the box with a tether to a backyard or doorstep. Wing's drones weigh about 10 pounds and will be able to carry packages that weigh about 2 to 3 pounds, Burgess said. The aircraft will fly 60 to 70mph and can travel about 6 miles one way. The company said items will be delivered within 5 to 10 minutes of ordering."

(3) *Dig, Baby, dig.* Elon Musk's Boring Company is preparing to dig its first commercial tunnel in Sin City. A Twitter user posted pics of large equipment being positioned to start construction of three Las Vegas tunnels, according to a 9/24 [Teslarati article](#). Boring won the \$48.6 million project last spring, and Musk has said it could be completed by the end of this year even though the project's official due date is 2021.

The project involves one pedestrian tunnel and two vehicle tunnels that connect two Las Vegas Convention Center buildings about a mile apart. But make no mistake: This is no hyperloop. Modified Tesla EVs that can carry up to 16 passengers are expected to shuttle people between the two buildings at high speeds. Initially, they will be manned by humans, but the hope is that they will work autonomously in the future.

Consumer Discretionary: Used Autos Cruising. We've penned quite a bit about the woes of the auto industry both at home and abroad. However, if CarMax's results are any indication, the ills of the new car industry are benefitting sellers of used cars. Let's take a drive-by:

(1) *Car sales go omnichannel.* CarMax, a used car dealer, reported that its revenue rose 9.1% in its fiscal Q2 ended 8/31, with sales in stores open more than a year increasing 3.2% and total used car sales rising 6.2%. The company is in expansion mode both online and on land. CarMax opened 18 stores over the past year and plans to open another 13 stores over the next 12 months. In addition, it's rolling out omnichannel shopping, where consumers can shop online and purchase online or in a showroom. In some markets, consumers can find a car they like online and CarMax will bring it to their home for a test drive.

(2) *Pricier autos.* Both used and new car prices are increasing, but new car prices are increasing faster, with the price gap between new and three-year-old vehicles widening to \$14,443. according to a Q2 [report](#) from Edmund's. That explains why the 12-month moving average of new car dealers retail sales hit a new high of \$78.5 billion in July, even as the number of new cars sold has stalled ([Fig. 8](#) and [Fig. 9](#)).

(3) *Tech pumps up the prices.* A big reason that new cars are rising in price is all the new tech bells and whistles consumers can opt for today. As for used car prices, Edmund's explains that they are rising because there are more SUVs in the mix, there are more younger cars coming off leases, and the increased technology hiking new car prices boosts used car prices too. The average price of a used car has jumped to \$20,700 in Q2 from \$17,900 in 2014.

“[A]s equipment becomes more tech-focused, shoppers face the prospect of purchasing a vehicle that quickly becomes out-of-date. But for those who aren’t in need of the latest and greatest, there will be even more value in buying used,” the report concludes.

CALENDARS

US. Thurs: Real GDP & PCE 2.0%/4.7%, GDP Price Deflator & Core PCED 2.4%/1.7%, Jobless Claims 211k, Advance Merchandise Trade Balance -\$73.4b, Pending Home Sales 1.0%, Kansas City Fed Manufacturing Index, Wholesale Inventories 0.2%, EIA Natural Gas Storage, Bullard, Clarida, Kashkari, Kaplan. **Fri:** Personal Income & Spending 0.4%/0.3%, Headline & Core PCED 1.3%/1.6% y/y, Consumer Sentiment Index 92.1, Durable Goods Orders Headline, Ex Transportation, and Core Capital Goods -3.1%/0.1%/1.0%, Baker-Hughes Rig Count, Quarles. (DailyFX estimates)

Global. Thurs: UK Gfk Consumer Confidence -14, Japan Headline, Core, and Core-Core CPI 0.5%/0.6%/0.6% y/y, China Industrial Profits, ECB Publishes Economic Bulletin, Draghi, Carney, Kuroda, Cunliffe. **Fri:** Eurozone Economic Sentiment Index 103.0, DeGuindos, Saunders, Weidmann. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): The Bull/Bear Ratio (BBR) moved further above 3.00 this week, as bullish sentiment climbed further above 50.0%. The BBR increased for the fourth week to 3.28 this week after falling from 2.74 to 2.35 four weeks ago. Bullish sentiment jumped 11.2ppts—to 55.1% from 43.9%—over the four-week period, as the correction count dropped 9.3ppts to 28.1% from 37.4%. It was the most bulls since the 57.2% recorded during the final week in July. There have been wide swings between the bullish and correction camps since early June. Meanwhile, bearish sentiment fell for the third week from 18.7% to 16.8%—the lowest percentage since mid-July—after fluctuating in a narrow band from 17.9% to 18.7% the prior seven weeks. The AAI Ratio climbed for the third week to 56.0% last week from 38.2% three weeks ago, as bullish sentiment rose from 26.1% to 35.3% over the three-week span while bearish sentiment fell from 42.2% to 27.8%.

AC World ex-US MSCI ([link](#)): This index has risen 3.2% in dollar terms so far in September, and is up 9.8% ytd. In local-currency terms, the index is up 3.0% in September compared to an 11.4% gain for all of 2019. The US dollar price index is up 12.1% since its December low and has improved to 14.3% below its cyclical high in January 2018. It had been down as much as 23.6%—and in a bear market—in December. The local-currency price index is up 13.3% since its December low to 7.2% below its record high in January 2018. It had been down as much as 18.1% on 12/26. Local-currency forward revenues is down 0.9% from its record high in early May, but is up 16.1% from a five-year low in March 2016. Local-currency forward earnings weakened to 5.1% below its record high in early November. Revenues are expected to rise 3.1% in 2019 and 4.2% in 2020 following a gain of 7.2% in 2018, and earnings are expected to rise 1.5% (2019) and 9.7% (2020) after rising 4.7% (2018). The industry analysts’ sales forecasts imply short-term 12-month forward revenue growth (STRG) of 4.0%, down 0.2ppt m/m. Their STRG forecast compares to a seven-year high of 6.8% in March 2017 and is up from a cyclical low of 2.3% in March 2016. Their short-term 12-month forward earnings growth (STEG) forecast improved 0.1ppt m/m to 7.5%. That’s up from a 10-year low of 6.0% in February and compares to a four-year-high forecast of 14.1% in March 2017. The profit margin implied by analysts’ earnings and revenue estimates calls for a drop to 7.5% in 2019, from 7.6% in 2018, and an increase to 7.9% in 2020. The forward profit margin forecast of 7.8% was unchanged m/m, but is down from a nine-year high of 8.3% in October. The Net Earnings Revision Index (NERI) for the AC World ex-US MSCI was negative in September for an 18th straight month following six positive readings. It edged up to -7.7% from -7.8% in

August and is up from its 33-month low of -8.4% in January. That compares to a 76-month high of 2.7% in May 2017 and a 51-month low of -11.3% in March 2016. The forward P/E rose 0.6pt m/m to 13.3, which is up from a five-year low of 11.4 in late December. That compares to a six-year high of 15.3 in April 2015, and a cyclical bottom of 12.3 in January 2016. The index's current 13% discount to the World MSCI P/E is up from its record-low 15% discount during early November.

EMU MSCI ([link](#)): The EMU's MSCI price index is up 2.5% in dollar terms so far this month and up 11.2% for 2019 to date. In euro terms, the price index is up 2.6% in September, compared to a 15.6% gain ytd. The US dollar price index is up 13.9% since its December low and has improved to 16.3% below its cyclical high in January 2018. It had been down as much as 26.5% and in a bear market in December. The local-currency price index is up 18.0% since its December low to 6.1% below its cyclical high in January 2018. It had been down as much as 20.5% on 12/27. Euro-based forward revenues rose 0.3% m/m, but remains down 1.0% from its five-year high in early November. That's still 5.3% above its six-year low in May 2016 but 5.9% below its record high (in September 2008). Euro-based forward earnings had stalled from 2011 to 2016 before reaching its highest level in 10 years during early November. It was up 0.5% m/m to 3.0% below its 10-year high in November and 18.1% below its record high (January 2008). Analysts expect revenues to rise 2.4% in 2019 and 3.8% in 2020, above the 2.0% in 2018. They're looking for earnings to rise 1.0% in 2019 and 10.6% in 2020 following a gain of 3.4% in 2019. Forecasted STRG of 3.5% is unchanged from a month earlier, which compares to a six-year high of 5.0% in April 2017 and a cyclical low of 2.0% in May 2016. Forecasted STEG rose 0.5ppt m/m to 8.3%, which compares to a 78-month high forecast of 21.0% (February 2017) and a seven-year low of 5.7% (April 2016). STEG had been higher than LTEG (currently 9.3%) from July 2016 to May 2017, but is trailing now. The forward profit margin was steady m/m at 7.7%, which compares to a nine-year high of 7.9% in January and a cyclical bottom of 6.2% in May 2013. The implied profit margin is expected to edge down from 7.5% in 2018 to 7.4% in 2019 before improving to 7.8% in 2020. NERI was negative in September for a 12th straight month and in 23 of the past 26 months. NERI weakened m/m to -7.9% from -7.7%, but remains above December's 31-month low of -8.7%. That compares to an 11-year high of 8.1% in May 2017. The P/E improved 0.5pt m/m to 13.4 and is up from 11.3 in early January, which was then its lowest reading since July 2013. That's down from a nine-month high of 14.9 in January 2018 and compares to a 13-year high of 16.4 in April 2015 and a 30-month low of 12.2 in February 2016. The current valuation represents a 12% discount to the World MSCI's P/E now, up from February's 14% discount, which was then the lowest since August 2016. That compares to a record-low 25% discount during 2011 and is well below the 1% premium during April 2015—the post-euro-inception record high.

Emerging Markets MSCI ([link](#)): The EM MSCI price index has risen 2.7% in US dollar terms so far in September to a gain of just 4.7% ytd. In local-currency terms, EM is up just 6.4% ytd after a 2.1% gain so far this month. The US dollar price index is up 8.1% since its October low and still in a bear market now at 20.6% below its cyclical high in January 2018. It had been down as much as 26.6% last October from its cyclical high. The local-currency price index is up 9.2% since its October low to 13.7% below its cyclical high in January 2018. It had been down as much as 20.9% on 10/29. Local-currency forward revenues fell 1.8% m/m to 4.7% from its record high in early May, but is still up 17.4% from a four-year low in June 2016. Local-currency forward earnings fell 0.7% m/m to 9.6% below its record high in October. Still, it's up an impressive 27.0% from its six-year low in April 2016. Revenue growth is expected to slow markedly to 5.0% in 2019 and 7.2% in 2020 from an 11.8% gain in 2018. That's expected to lead to earnings gains of 2.3% in 2019 and 13.4% in 2020, following a 7.5% gain in 2018. Forecasted STRG was unchanged m/m at 6.6%, which compares to a 34-month low of 5.8% in February and a four-year high of 9.6% in January 2017. STEG rose 0.4ppt m/m to 10.8%; that's up from a 10-year low of 6.6% in late January but remains well below its cyclical peak of 17.5% in March 2017 and is below LTEG (14.0%) again. The implied profit margin drops from 6.5% in 2018 to 6.4% in 2019 before improving to 6.7% in 2020. The forward profit margin improved 0.1% to 6.6%, which is

down from a six-year high of 7.4% in April 2018. It's now 3.7ppts below its 10.3% record high in December 2007 and compares to a record low of 6.0% in February 2016. NERI was negative for a 20th month in September, but improved to -7.0% from -7.4% in August. NERI had been positive for only three months through January 2018 after 80 months of negative readings through October 2017, and compares to an 83-month low of -10.2% in March 2016. Emerging Markets' forward P/E of 12.0 is up from a 56-month low of 10.0 at the end of October and compares to an eight-year high of 13.1 in January 2018. The index is trading at only a 22% discount to the World MSCI P/E, which is near the best levels since early 2013. That's up from a four-year-low 27% discount in late October and compares to a 10-year-low 30% discount in August 2016.

MSCI World & Region Net Earnings Revisions ([link](#)): Analysts' recent earnings revisions through September suggest increasing pessimism about profits in Europe and in the US, but the Emerging Markets have improved slightly from their recent lows. The AC World ex-US MSCI's NERI was negative for an 18th month, but edged up to -7.7% from -7.8% in August. That's up from a 33-month low of -8.4% in January. EM Eastern Europe remains in the lead among all regions, but fell the most in September. The US's NERI was negative for the tenth time in 11 months, slipping to -6.2% (from -6.0%)—well below its corporate-tax-rate-cut-boosted record high of 21.8% in March 2018. Here are September's scores among the regional MSCIs: EM Eastern Europe (-3.5% in September, down from -3.1% in August), EM Latin America (-5.6 [20-month low], -6.5), United States (-6.2, -6.0), Emerging Markets (-7.0 [20-month low], -7.4), EM Asia (-7.0 [20-month low], -7.5), Europe (-7.1, -6.6), AC World (-7.3, -7.3), AC World ex-US (-7.7 [18-month low], -7.8), Europe ex-UK (-7.8, -7.6), EMU (-7.9, -7.7), and EAFE (-8.4, -8.2).

MSCI Countries Net Earnings Revisions ([link](#)): NERI was positive for 2/44 MSCI countries in September, the lowest count since March 2016 and down from 3/44 in August. That compares to 11/44 countries positive in May, which was the highest reading since October. NERI improved m/m in September for 17/44 countries, up from 15/44 in August. That compares to 32/44 improving in May, which was then the highest count since July 2018. Among the countries with improving NERI in September, Taiwan was at a 12-month high, followed by 11-month highs for Israel, Korea, and Portugal. Among countries with weaker NERI m/m, Australia was at an 82-month low, followed by Malaysia (46), Hong Kong (42), and Spain (41). The two-month positive NERI streaks for Hungary and Israel are the best among countries. Greece had its NERI turned negative m/m. South Africa's NERI has been negative for 64 straight months, followed by the negative streaks of Mexico (35 months), Denmark (26), and Germany (26). The highest NERI readings in September: Israel (6.8), Hungary (1.1), the Philippines (-0.6), Brazil (-0.6), and Greece (-0.8). The weakest NERIs occurred this month in Peru (-18.5), India (-17.5), Australia (-14.6, 82-month low), Ireland (-14.5 [22-month low]), and South Africa (-12.3).

US ECONOMIC INDICATORS

New Home Sales ([link](#)): New home sales remain on a volatile uptrend, climbing for a fifth time this year in August. New home sales last month rebounded 7.1% to 713,000 units (saar), after plummeting a revised 8.6% in July—considerably narrower than the initial estimate of a 12.8% loss. Year to date, total sales are up 26.4%, with sales in the West (57.9% ytd), South (21.4), and Northeast (18.5) posting double-digit gains and the Midwest (-1.5) nearing positive territory. The supply of new homes on the market fell again this month, to 326,000 units, the fewest since September 2018 and down 5.8% since the end of last year. The months' supply fell to 5.5 from a recent peak of 7.4 months' in December. Roughly 63% of the houses sold in August were either under construction or yet to be built. The National Association of Home Builders Housing Market Index (HMI) for September shows homebuilders' confidence continued to trend higher since bottoming at the end of last year. The overall index climbed to 68 from 56 last December, with current sales (to 75 from 61 in December) and buyer

traffic (50 from 43) heading up and expected sales (70 from 61) moving sideways for the past six months.

Contact us by [email](#) or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-775-6823

Copyright (c) Yardeni Research, Inc. Please read complete [copyright and hedge clause](#).