



## MORNING BRIEFING

November 14, 2019

### A Couple of Consumer Discretionary Industries

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

(1) Two S&P Consumer Discretionary sector industries may be headed out of favor with buyers of their products and their stocks: Homebuilding and Internet Retail. (2) Consumers know value when they see it and wait for it when they don't. (3) Consumer discretion: the better part of *value*? (4) Rising mortgage rates and home prices aren't good for homebuilders. (5) Elevated valuations aren't good for their stocks' future performance. (6) Internet retailers' share prices have lagged the broader market, but perhaps justifiably so given diverse woes. (7) 3-D printing makes itself at home—and work.

**Consumer Discretionary I: Has Housing Had Its Heyday?** Everyone loves a bargain. It's the reason shoppers stand in line for hours after Thanksgiving dinner and risk their bosses' ire by trolling the Internet on Cyber Monday. Homebuyers are no different. When the 30-year mortgage interest rate began to fall late last year, prospective home buyers saw their opportunities and pounced ([Fig. 1](#)). The 2018 slump in existing home sales quickly reversed and has remained near the highest levels of the past four years.

But after five months of strong sales, homebuilding stocks face two problems. First, there's a lot of good news baked into their stock prices; the stocks trade near all-time highs and have been among the best performers in the S&P 500 over the past year. Second, interest rates may have hit their nadir. If so, they won't likely provide any additional help to the industry and might become a hindrance. Here's Jackie's look at some of the industry's fundamentals:

(1) *Low rates have improved affordability.* Late last year, the Federal Reserve was expected to continue raising the federal funds rate into 2019. When the reverse became reality, the interest rate on the 30-year fixed-rate mortgage fell to a low of 3.60% on 9/5, down from a high of 4.99% in early November 2018 ([Fig. 2](#)). The lower cost of borrowing helped make buying a home much more affordable ([Fig. 3](#)).

In Q3-2018, the median price of a single-family home peaked at \$266,500, and the average mortgage rate hit 4.77%. Homeowners' average monthly principal and interest payment rose to \$1,115, representing 17.4% of the average homeowner's income (up from 15.8% in 2017 and 15.0% in 2016), according to [data](#) from the National Association of Realtors (NAR). Fast-forward to Q3-2019: According to NAR's preliminary data, the mortgage rate fell to 3.71% in Q3-2019, the monthly principal and interest payment dropped to \$1,033, and that payment as a percentage of income slid to 15.6%.

So why worry? Because the interest rate on the 30-year mortgage has started to creep higher. Currently at 3.96%, the rate might head higher still if the US and China ever strike a trade deal. And Fed Chair Jerome Powell indicated on Wednesday that the Fed is back in pause mode. We expect that the Fed will leave interest rates unchanged through next year's elections. The events of 2018 made it clear that very small increases in mortgage rates have an outsized impact on the housing market in today's low-interest-rate world.

(2) *Home prices keep rising.* After bottoming in February 2012, the average and median prices of existing single-family homes have crept higher every year ([Fig. 4](#)). And in some of the hottest real estate markets, home prices are rising by percentages in the double digits. Ogden, Utah has been dubbed the “hottest” real estate market, as it’s attracting buyers from other nearby expensive states. The one-year change in list price was 13.5%, and the projected one-year change is 7.8%, according to a 9/26 [article](#) in Construction Coverage.

In order to ensure its homes are affordable, DR Horton started building smaller homes. “[W]e continue to see our average square footage come down slightly. It was down about 3% on a year over year basis again. And we’ve proactively gotten the houses out there that we believe are affordable in today’s market,” said Jessica Hansen, vice president, Investor Relations on the company’s fiscal Q4 [conference call](#).

(3) *Stock prices keep rising.* With interest rates low and sales humming, the S&P 500 Homebuilding industry has been one of the top-performing industries we cover. It’s up 50.8% ytd, making it the sixth-best-performing industry in the S&P 500 on a ytd basis, and up 52.2% y/y, making it the fourth-best-performing industry on that basis ([Fig. 5](#)).

The Homebuilding industry is expected to produce respectable results this year and next, with revenue forecast to rise 5.3% in 2019 and 5.4% in 2020 ([Fig. 6](#)). Earnings are expected to jump 7.5% this year and 8.6% next year ([Fig. 7](#)). The S&P 500 Homebuilding industry’s forward P/E has rebounded to 11.4, leaving it somewhat elevated ([Fig. 8](#)).

(4) *Inventories still low.* The best things the housing market has going for it now are low inventories and a strong job market. At 1.61 million units, the existing single-family homes available for sale are fewer than half that in 2006 and on par with the lows of 2000 despite the population growth since then ([Fig. 9](#)). Strong employment levels and wage gains also help buyers keep up with home price increases. Unemployment remains near an all-time low of 3.6%, and real wages are edging higher ([Fig. 10](#) and [Fig. 11](#)).

But those job market dynamics were also true in 2018, and it wasn’t enough to offset the downward pull that higher interest rates had on housing sales. If interest rates head much higher, bargain shoppers will likely walk away and wait for a better deal.

**Consumer Discretionary II: Internet Retail Falling Behind.** The S&P 500 Internet & Direct Marketing Retail industry—home to powerhouses Amazon, Expedia Group, and Ebay—is conspicuously absent from this year’s stock price leader board. The industry’s stock price index rose at a compounded annual growth rate (CAGR) of 28.4% during 2003-18, trouncing the S&P’s 6.8% CAGR over that period. But this year, the industry’s stock price index has sputtered ([Fig. 12](#)).

The S&P 500 Internet Retail stock price index has gained 16.9% ytd through Tuesday’s close, lagging behind the S&P 500’s 23.3% ytd appreciation. Likewise, the Internet Retail index has climbed 7.3% y/y, almost half the S&P 500’s 13.4% y/y return. Let’s take a look at what knocked the Internet Retail industry off its leadership perch:

(1) *Earnings and P/E tumbling.* The S&P 500 Internet Retail industry’s forward earnings forecasts have fallen 14% since mid-July ([Fig. 13](#)). Once expected to grow by more than 40%, the industry’s 2019 earnings are now expected to gain only 7.5% ([Fig. 14](#)). Next year, the above-market earnings growth rate returns: 22.4%.

The Internet Retail industry’s forward earnings multiple has shrunk as well. Last year, its forward P/E

was north of 80. Today, it's only 45.8 ([Fig. 15](#)). The Internet Retail sector has the biggest impact on the S&P 500 Consumer Discretionary industry. Joe reports that Internet Retail earnings represent 16% of the S&P 500 Consumer Discretionary sector's forward earnings, ahead of Home Improvement Retail's 14%. And the sector's 21.8 forward P/E shrinks to 17.1 if the Internet Retail industry is excluded ([Fig. 16](#)).

(2) *A trip to nowhere.* The Internet Retail industry was grounded last week when Internet travel companies Expedia and TripAdvisor reported disappointing earnings. They blamed changes in Google's search algorithm, which they say began to display their websites further down the list of search results, an 11/7 *WSJ* [article](#) reported. The Internet travel companies are expected to respond by spending more on digital and TV advertising, which could hurt earnings.

Expedia shares have been the worst performers in the S&P 500 Internet Retail index, falling 15.1% ytd and 21.8% y/y. Booking Holdings—which owns online reservation companies Kayak.com, Booking.com, and OpenTable—beat earnings estimates, and its shares haven't fallen as sharply, less than 10% ytd.

(3) *Not so amazing.* Amazon stock is doing better than the Internet travel retailers, but it's still lagging behind the S&P 500. Up 18.4% ytd and 8.6% y/y, the company's performance is trumped by that of the S&P 500 (23.3% ytd and 13.4% y/y).

Amazon has come under attack from various angles. On the retail front, the *WSJ* discovered that 10,870 items Amazon has come under attack from various angles. On the retail front, the *WSJ* discovered that 10,870 items being sold by other retailers through Amazon's website between May and August lacked required warnings or were deemed unsafe, deceptive, or banned by federal agencies, an 8/23 [article](#) reported. Of the 1,934 sellers whose addresses could be determined, 54% were based in China.

Amazon has recruited Chinese manufacturers and merchants to sell their products on Amazon, an 11/11 *WSJ* [article](#) reported. The paper discovered Chinese sellers marketing products deceptively. Amazon's response: "Bad actors make up a tiny fraction of activity in our store and, like honest sellers, can come from every corner of the world. Regardless of where they are based, we work hard to stop bad actors before they can impact the shopping or selling experience in our store."

The latest retail black eye comes from Nike, which this week said it would stop selling its products directly to Amazon. "Nike executives were unhappy with how unauthorized sellers continued to be widely available on Amazon, according to people familiar with the matter," an 11/12 *WSJ* [article](#) reported.

Amazon's cash cow is its fast-growing, high-margin web services business. But it too received a black eye when it lost a head-to-head bakeoff against Microsoft's cloud business, Azure, for a \$10 billion Defense Department contract. Microsoft's Azure has less market share than Amazon, but the government contract win may cause corporate IT decisionmakers to give Azure a second look, an 11/2 *MarketWatch* [article](#) noted.

Lastly, Amazon is spending with abandon. It's building a one-day package-delivery system. It continues to build out its cloud. And the company is taking on Hollywood, producing movies and TV series to show over its streaming service. Amazon's profit fell y/y in Q3 for the first time in more than two years. It's expected to decline again in Q4. It may take a while for the Internet Retail industry to return to the market-beating powerhouse it was in the past.

**Disruptive Technology: 3-D Printing Update.** 3-D printing is progressing slowly, but it is progressing. We recently came across two features. One looked at how it's being used to build homes. The other discussed the various ways manufacturers are employing the technology. Here are some of the highlights:

(1) *3-D printing at work.* Manufacturers are increasingly using 3-D printed items to cut costs and save time. 3-D printing is being adopted first by companies that manufacture or need low-volume, high-value parts, an 11/9 CNBC [article](#) reported. IDTechEx estimates in the article that the market for 3-D printing should grow 13% annually, from \$10 billion today to \$31 billion by 2029.

A diverse group of companies uses the technology. Workers on a North Sea oil rig use a 3-D printer to make replacement parts on the spot instead of waiting days for a delivery by air or sea. L'Oreal is using 3-D technology to print prototypes of its projects, and now it's using the technology to create human skin. With bioprinting, layers of living cells are used to create human skin on which L'Oreal can test its products instead of using animals. And in the dental community, 3-D printers are creating more precise crowns and dentures.

(2) *3-D printing at home.* Want to vacation in a 3-D printed home? You might be able to as soon as this spring in Garrison, New York on the Hudson River. The TERA project is building two-story structures using 3-D printing technology, according to an 11/8 *NYT* [article](#). It's just one of the 3-D printed neighborhoods cropping up.

ICON is building small 3-D printed homes for the homeless. It built a 350-square-foot house that was printed with a machine in just 47 hours over several days at a cost of \$10,000 for the printed elements. ICON has plans to print 50 houses for a poor community in an undisclosed location in Latin America. It's also working on a 51-acre development for the homeless outside Austin, Texas.

In the Netherlands, Project Milestone is building five 3-D printed homes that will use various materials and designs. Expected to be completed in early 2020, the homes will be sold to a real estate company and leased out. In Italy, WASP built a 323-square-foot house from local soil and rice-cultivation waste. WASP aims to use materials sourced near where the home is built to reduce the energy and waste involved with current homebuilding techniques.

## CALENDARS

**US. Thurs:** Jobless Claims, PPI Final Demand 0.3%/m/m/0.9%/y/y, DOE Crude Oil Inventories, EIA Natural Gas Report, Powell, Williams, Bullard, Clarida, Evans, Quarles, Kaplan. **Fri:** Retail Sales Total, Ex Autos, Ex Autos & Gas, and Control Group 0.2%/0.4%/0.3%/0.3%, Industrial Production Total & Manufacturing -0.4%/-0.4%, Capacity Utilization 77.1%, Business Inventories 0.1%, Empire State Manufacturing Index 6, Import Price Index -0.2%/m/m/-1.9%/y/y, Baker-Hughes Rig Count. (DailyFX estimates)

**Global. Thurs:** Eurozone GDP 0.2%/q/q/1.2%/y/y, Eurozone Employment, Germany GDP -0.1%/q/q/0.4%/y/y, UK Retail Sales Including & Excluding Fuel 3.7%/34.% y/y, Japan Industrial Production, Mexico Overnight Rate 7.50%, Guindos, Knot, Poloz. **Fri:** Eurozone Headline & Core CPI 0.7%/1.1% y/y, Eurozone Trade Balance €18.7b, Mersch. (DailyFX estimates)

## STRATEGY INDICATORS

**Stock Market Sentiment Indicators** ([link](#)): The Bull/Bear Ratio (BBR) ratio climbed for the fifth week this week as bullish sentiment continued to increase and the correction count continued to decrease,

though both to a lesser extent than prior weeks. Our BBB rose to 3.22 this week from 2.77 five weeks ago, after falling from 3.28 to 2.77 the prior two weeks. There have been wide swings between the bullish and correction camps since early June. Bullish sentiment is up 10.0ppts the past five weeks to 57.6%, after plunging 7.7ppts the prior week from 55.3% to 47.6%. Meanwhile, the correction count is down 10.7ppts the past five weeks to 24.5%, after jumping 7.6ppts the prior week to 35.2%. Bearish sentiment ticked down to 17.9% this week after ticking up from 17.8% to 18.1% last week—fluctuating in a narrow band most of this year. The AAll Ratio rebounded to 62.7% last week after falling from 55.7% to 54.4% the prior week, as bullish sentiment rose from 34.0% to 40.3% and bearish sentiment fell from 28.4% to 23.9%.

**S&P/Russell LargeCaps & SMidCaps** ([link](#)): All of these Russell and S&P price indexes have healthy gains so far in 2019; only one, the S&P SmallCap 600, is still in correction territory measured from the indexes' record highs. Here's how they rank ytd through Tuesday's close, along with their percentage changes since their record highs: Russell LargeCap 1000 (23.4% ytd, 0.0% from record high), S&P LargeCap 500 (23.3, 0.0), S&P MidCap 400 (19.7, -2.9), Russell SmallCap 2000 (18.3, -8.4), and S&P SmallCap 600 (16.6, -10.3). All of these indexes are up since 7/30, the day before the Fed announced their first fed funds rate cut in over 10 years: S&P 500 (2.6%), Russell LargeCap 1000 (2.3), S&P SmallCap 600 (1.8), Russell SmallCap 2000 (0.6), and S&P MidCap 400 (0.2). These indexes began a forward-earnings uptrend during March, but only LargeCap is near a record high. LargeCap's forward earnings has risen during 28 of the past 39 weeks, MidCap's 19 of the past 35 weeks, and SmallCap's 17 of the past 33 weeks. LargeCap's is just 0.3% below its record high eight weeks ago, while MidCap's and SmallCap's are 5.2% and 8.9% below their October 2018 highs. MidCap's forward earnings is near a 17-month low now, while SmallCap's forward earnings is near September's 17-month low because analysts are now including a large goodwill writeoff in their 2019 annual forecast for Frontier Communications. Analysts had been expecting double-digit percentage earnings growth for 2019 during October 2018, but those forecasts are down substantially since then. Here are the latest consensus earnings growth rates for 2018, 2019, and 2020: LargeCap (22.7%, 0.6%, 10.1%), MidCap (22.7, -6.8, 12.7), and SmallCap (22.4, -17.7, 36.4).

**S&P 500 Growth vs Value** ([link](#)): The S&P 500 Growth and Value price indexes are at or near record highs and remain strong ytd. Value now leads with a gain of 23.9% ytd through Tuesday's close and is attaining record highs for the first time since 1/26/18. Growth is up 22.9% ytd but down just 0.2% from its record high on 7/26. Both of these indexes are up since the Fed cut the fed funds rate at the end of July, but Value is outperforming hugely with a gain of 4.9% since then versus a 0.6% rise for Growth. Since the election in late 2016, Growth's 54.7% gain continues to outpace the 33.0% increase logged by Value. Looking at the fundamentals, Growth is expected to deliver higher revenue growth (STRG) and earnings growth (STEG) than Value over the next 12 months. Specifically, 8.2% STRG and 11.2% STEG are projected for Growth, respectively, versus 3.6% and 6.4% for Value. Growth's valuation peaked at 21.8 on 7/26, matching January 2018's highest level since the Tech bubble deflated in 2002. Through Tuesday, Growth's P/E was down to 21.5, up from its 50-month low of 15.9 on 12/24. Value's forward P/E has rallied from its recent low of 13.1 in mid-August to 14.8, which is the highest since March 2018. That's up from a six-year low of 11.5 on 1/3 of this year, but down from a 16-year high of 16.6 on 1/3/18. Regarding NERI, Growth's was negative in October for a third straight month, weakening to a seven-month low of -2.3% from -1.7% in September. That compares to a 25-month low of -4.4% in February and a record high of 22.3% in March 2018. Value's NERI was negative in October for a 12th month, and edged down to -8.0% from -7.7%; that compares to a 34-month low of -9.8% in February and a record high of 21.2% in March 2018. The Tax Cuts and Jobs Act (TCJA) sharply boosted the consensus forward earnings estimates and the forward profit margin for both Growth and Value. Growth's forward profit margin of 15.8% is up from 14.4% prior to the TCJA's passage but down from its record high of 16.7% during September 2018. Value's forward profit margin of 10.1% is down from a record high of 10.5% in December 2018, but up from 9.1% prior to the TCJA.



## US ECONOMIC INDICATORS

**CPI ([link](#)):** October's core CPI rate remained above the Fed's 2.0% target rate, though ticked down to 2.3% y/y from its recent peak rate of 2.4% during August and September. (It first reached 2.4% during July 2018—which was the highest since September 2008.) Before accelerating to 2.4% this August, the core rate had fluctuated in a narrow band from 2.0% to 2.2% for 12 months. Core prices rose 0.2% last month, after increases of 0.1% and 0.3% the prior two months; the three-month rate slowed for the second month, to 2.2% (saar), after accelerating from 1.6% in May to 3.4% in August—which was the fastest pace since May 2006. Here's a ranking of the 12-month core rates in October from lowest to highest for goods: apparel (-2.3% y/y), new vehicles (0.1), medical care commodities (1.0), alcoholic beverages (1.0), used cars & trucks (1.4), and tobacco & smoking products (4.9)—with only the rate for medical care commodities accelerating. Here's the same drill for the core services rates: motor vehicle insurance (-0.2), physicians' services (1.2), airfares (1.5), hospital services (3.5), motor vehicle maintenance & repair (3.4), owners' equivalent rent (3.3), and rent of primary residence (3.7)—with both physicians' and hospital services rates on accelerating trends. The headline CPI rate ticked up to 1.8% y/y, remaining below 2.0% for the ninth time this year; it was at a recent high of 2.9% during June and July 2018.

## GLOBAL ECONOMIC INDICATORS

**Eurozone Industrial Production ([link](#)):** Output in September ticked up for the second month—the first back-to-back gains since the final two months of 2017—after falling four of the prior five months to its lowest level since March 2017. Production began 2019 with a 1.7% jump, though quickly lost momentum. Industrial production (excluding construction) climbed 0.5% during the two months through September, after declining five of the previous six months by 1.9%. Production is basically flat ytd, showing a mixed picture. Here's a list of the main industrial groupings, with only intermediate (-3.0% ytd) and energy (-1.3) output down ytd. Meanwhile, capital goods output is showing signs of life, rebounding 4.0% during the three months through September after sliding 4.8% the prior three months—with the ytd (0.9%) rate moving into positive territory. Consumer goods output is up 2.8% ytd, led by a 3.4% advance in nondurable goods; durable goods production was basically unchanged at 0.4% ytd. Looking at the ytd performance for the top four Eurozone economies shows a mixed bag, with Spain (2.6% ytd) posting a solid gain and Germany (-4.3) recording a sizable decline, while Italy (0.6) and France (0.1) were little changed.

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