Yardeni Research

MORNING BRIEFING
December 12, 2019

Pedal to the Light-Truck Metal

See the pdf and the collection of the individual charts linked below.

(1) Auto manufacturers in the slow lane, hurt by international sales and EV investments. (2) Auto retailers in the fast lane, thanks to used light-truck sales. (3) Zero trade fees help brokers battle Fin Tech upstarts. (4) Shareholders like Schwab's recent moves. (5) Fin Tech companies pressuring asset management fees too. (6) Tesla's solar roofs may have their day in the sun.

Auto Makers & Retailers: In the Slow & Fast Lanes. Companies that make cars are having a tough year, but companies that sell new and used cars are doing just fine. Those two ideas seem contradictory, but they are not. The shares of GM and Ford Motor are trailing the broader market, up 5.0% and 18.6% ytd through Tuesday's close, while the shares of AutoNation, CarMax, and Group 1 Automotive are trouncing the market, up 42.7%, 54.5%, and 95.7%! I asked Jackie to take a look at what's driving the disparate experiences:

(1) *A world of hurt.* US new motor vehicle sales, at 17.2 million saar in November, were down 1.3% y/y, driven by a 12.5% plunge in auto sales; light-truck sales were up 3.6% y/y—climbing to record highs (*Fig. 1*). However, GM and Ford sales span the world, making their results more than just a reflection of what's occurring in the US.

GM's North American operating profit rose 7.0% y/y to $3.0 billion in Q3, while its International business dropped to a $65 million loss, down from a $139 million profit a year ago, according to the company's 10/29 press release. The company's autonomous division, Cruise, also lost money to the tune of $251 million last quarter. Were it not for an increase in the profit kicked in by GM Financial, the drag from the International and Cruise divisions would have been even more evident. GM Financial's Q3 operating profit rose to $711 million from $498 million a year earlier.

It's a similar scenario at Ford, where US revenue rose 5% in Q3 y/y; but this company presented a much darker picture of international operations. Ford's Q3 revenue fell in South America (-19% y/y), Europe (-14), Middle East and Africa (-2), China (-27), and Asia Pacific (-12), according to its 10/23 press release.

(2) *Hot used wheels.* Unlike the auto manufacturers, auto retailers are largely domestic operations, selling both new and used autos and light trucks. While sales of new vehicles have been stagnant, the sale of used vehicles has risen sharply in recent years. Real personal consumption expenditures on used autos and light trucks is near record levels, having risen 98% since its January 2014 bottom. Real sales of used light trucks have raced ahead, soaring 150% over the period to new record highs, while used auto sales advanced a more subdued 38% (*Fig. 2*).

With operations across 16 states, AutoNation calls itself the nation's largest auto retailer. AutoNation's Q3 sales of new vehicles fell 2.0% y/y, but its Q3 sales of used vehicles rose 9.5%. Add in sales of financial and insurance services, car parts, and repair services, and the company's total revenue

increased 2.1% y/y last quarter, a 10/29 press release reported.

CarMax, the nation's largest retailer of used cars, reported that its fiscal Q2 sales rose 9.1% y/y and its net earnings increased 5.8% y/y. Its smaller competitor, Group 1 Automotive, posted a 7.9% y/y jump in total revenue and a 6.5% y/y increase in income from operations in Q3, according to its 10/24 press release. The company, which sells both new and used cars and operates collision centers, generates roughly two-thirds of its revenue in the US, with most of the remainder coming from the UK except for a sliver (i.e., 3.6%) from Brazil.

(3) *Ugly numbers.* The S&P 500 Automobile Manufacturers stock price index has gained 10.5% ytd through Tuesday's close, but trails the S&P 500's 25.0% jump (*Fig. 3*). The industry is expected to post a 4.9% drop in revenue this year, followed by a 2.3% increase in 2020 (*Fig. 4*). Likewise, two years of earnings declines (-14.5% in 2018 and an expected -18.2% this year) are forecast to be followed by a jump of 20.8% in 2020 (*Fig. 5*). Investors appear to be in show-me mode, as the industry's forward P/E is a lowly 6.2 (*Fig. 6*).

Disruptive Technology I: Brokers Battle Back. Fin Tech companies have been biting at the ankles of their larger brokerage trading counterparts for a few years. Upstarts like Robinhood, Betterment, and Wealthfront have entered the investing scene with free online trades and very inexpensive computer-generated advice. But Charles Schwab's moves this fall seem to have given investors confidence that the old dog's new tricks just might be what's needed to fend off the competition. Let's take a look at what Chuck's shop has done and how Schwab shares have reacted:

(1) *Slashed to zero.* The earth shook on 9/26 when Interactive Brokers announced it would offer commission-free, unlimited online trades on stocks and ETFs through a new account dubbed "IBKR Lite." Schwab responded quickly. On 10/1, the firm revealed that it too would offer free trades on stocks, ETFs, and options listed in the US and Canada through online accounts. Later the same day, TD Ameritrade followed suit with a zero-trading commission announcement.

The fall to zero continued this week: On Tuesday, Wells Fargo announced free online stock and ETF trades, and on Monday Bank of America's Merrill Edge broadened free trading beyond customers of a loyalty program to all of its self-directed brokerage customers. Said differently, the disrupted struck back at the disruptors. But that doesn't mean that the move won't be painful. Trading commissions made up about 7% of Schwab's revenue, a quarter of TD Ameritrade's revenue, and a fifth of E*TRADE Financial's revenue, a 10/1 *WSJ* article noted.

(2) *The threat continues.* Despite recent moves, the online brokerage industry remains under fire from the disruptors. Competition to lure assets is fierce. Betterment is offering up to 1.78% on cash reserves, Robinhood 1.80%, and Wealthfront 1.82%, according to their respective websites. That's much higher than the 0.06%-0.30% Schwab offers on uninvested cash in brokerage accounts or even the 0.18% yield on a Schwab Bank high-yield investor saving account.

The fees charged for giving advice are also under pressure. Wealthfront, a robo advisor with $22 billion under management, uses index funds to construct recommended portfolios. It charges a 0.25% advisory fee on assets under management; the ETFs it recommends charge fees between 0.06% and 0.13%, according to its website. Traditional financial advisors typically charge 1% to 2% of a client's assets annually, the *WSJ* article noted. At Schwab, investors who invest their cash in Schwab's bank can use the firm's portfolio-management algorithms for free.

(3) *Investors approve.* Schwab followed its earth-shaking zero-fee announcement with the $26 billion acquisition of TD Ameritrade Holding announced on 11/25. The market has given its seal of approval to

the company's bold moves. Schwab's shares are up 18.4% ytd, compared to TD Ameritrade share's 4.8% ytd return and E*TRADE's 3.4% return. Schwab's performance is even more impressive if you consider that the shares fell 20.5% from the start of the year through 10/3 and then gained 34.7% from 10/3 through Tuesday's close.

(4) *Brokers hold their own.* Schwab's trials and tribulations are lost when looking at the S&P 500 Investment Banking & Brokerage stock price index, which includes Schwab, Goldman Sachs, Morgan Stanley, E*TRADE, and Raymond James Financial. The index is up 24.3% ytd through Tuesday's close, having recently broken out of a year-long trading range, and it's keeping pace with the S&P 500, up 25.0% ytd (*Fig. 7*). The industry's revenue growth is expected to decline 0.6% this year and increase 1.3% in 2020 (*Fig. 8*). Likewise, earnings are forecast to fall 2.2% this year and increase 3.1% in 2020 (*Fig. 9*). Analysts have cut earnings estimates sharply over the past three months, and the industry's forward P/E stands at 11.4 (*Fig. 10*).

Disruptive Technology II: Smart Roofs. Tesla CEO Elon Musk unveiled the latest version of Tesla's solar roof in late October, and there have been some very important developments that might finally take solar energy mainstream. Most importantly: The price of the newly dubbed "Solarglass" is competitive, and its aesthetics have improved. It's the latest step toward Musk's belief that in time Tesla Energy (home to the solar roofs) will approximate the size of Tesla's auto business. Let's take a look at the progress:

(1) *Price.* The price of Tesla's Solarglass has come down sharply, 40% by one estimate. The overall cost has fallen to $33,950 after incentives for a 2,000-square-foot home with 10 kW of solar tiles installed, less than the $43,790 for a new roof with solar panels on it.

The individual roof tiles are much bigger than their predecessors, 45 inches long by 15 inches wide, which reduces the cost of production, increases the power density, and facilitates installation, a 10/28 Teslarati article reported. It's expected to take just as long as a traditional roof to install, roughly one day, down from the five to seven days needed to install earlier versions of Tesla solar roofs.

(2) *Appearance.* Just as important, Tesla solar panels now look sleek. Gone are the clunky eyesores of years past sticking up above the roofline. The company is currently producing tiles that look like dark traditional asphalt roof shingles. Eventually, the company plans to have the Solarglass in roofs that look like clay tile and French slate.

The roof has a 25-year warranty and is suggested for newly constructed homes or replacement of existing roofs with less than 10 years of life left. The solar roof tiles aren't as efficient at converting sun to electric as a traditional solar panel, but they can cover more of a roof's area, so they end up being more efficient as a whole, a 10/25 CNET article noted.

(3) *Good timing.* The timing of Tesla's Solarglass is fortuitous. California is making solar roofs mandatory for newly constructed homes in 2020. The state's Energy Commission estimates the new rule will add $8,000-$10,000 to the cost of a new home, increasing a monthly mortgage payment by $40 but reducing homeowners' utility bills by an average of $80 a month, a 2/17 CNBC article reported. Tesla's Solarglass looks like it will be competitive on its own merits. But a little kick from the Golden State couldn't hurt.

CALENDARS

US. Thurs: Jobless Claims 212k, PPI Final Demand 0.2%m/m/1.3%y/y, EIA Natural Gas Storage. **Fri:** Retail Sales Total, Ex Autos, Ex Autos & Gas, and Control Group 0.4%/0.3%/0.4%/0.3%, Business

Inventories 0.2%, Import Prices Headline and Ex Petroleum 0.2%/0.0%, Baker-Hughes Rig Count, Williams. (DailyFX estimates)

Global. Thurs: UK General Election, Eurozone Industrial Production -0.5%m/m/-2.4%y/y, Germany CPI -0.8%m/m/1.1%y/y, Mexico Industrial Production -1.6% y/y, France Sovereign Debt Rated by Fitch, ECB Central Bank Rate Decision 0.00%, ECB Marginal Lending & Facility Rates 0.25%.-0.50%, Lagarde, Poloz. **Fri:** BOE/TNS Inflation Next 12 Months. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) remained above 3.00 for the seventh week, though eased a bit again this week. The BBR slipped for the second week this week, to 3.10, after climbing from 2.77 to 3.40 the prior seven weeks. Once again, there were wide swings in bullish sentiment and the correction count. Bullish sentiment dropped 4.8ppts the past two weeks, to 53.3% this week, after jumping 10.5ppts (from 47.6% to 58.1%) the prior seven weeks. The correction count climbed 4.7ppts over the two-week period, to 29.5%, after falling 10.4ppts (from 35.2% to 24.8%) the previous seven weeks. Bearish sentiment ticked down to 17.2% from 17.3% this week—fluctuating in a narrow band most of this year. The AAII Ratio declined for the fourth week last week from 62.7% to 52.1% over the period. Bearish sentiment edged down to 29.1% after rising from 23.9% to 30.3% the prior three weeks, while bullish sentiment fell for the third week, from 40.7% to 31.7%.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): Consensus S&P 500 forward revenues and earnings rose last week, but remain a bit below their record highs in early October. Forward revenues and earnings are now just 0.1% below their record highs then. Analysts expect forward revenues growth of 5.0% and forward earnings growth of 9.4%, with the earnings measure up 0.6ppt w/w. Forward revenues growth is down 1.3ppt from a seven-year high of 6.3% in February 2018 and now matches its 31-month low of 5.0% in mid-February. Forward earnings growth is down 7.5ppts from a six-year high of 16.9% in February 2018 but is still comfortably above its 34-month low of 5.9% in February 2019. 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 4.0% in 2019 and 4.9% in 2020. They're calling for earnings growth to slow sharply from 24.0% in 2018 to 1.1% in 2019 before improving to 9.1% in 2020. The forward profit margin was steady w/w at a five-month low of 12.0% and is down 0.4ppt from a record high of 12.4% in September 2018. 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 0.4ppt y/y from 11.9% in 2018 to 11.5% in 2019 before improving to 12.0% in 2020. The S&P 500's forward P/E dropped 0.4pt w/w to 17.7 from a 22-month high of 18.1, primarily due to higher forward earnings. That's up from 14.3 during December 2018, 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 0.03pt w/w to 2.13 from a record high of 2.16. That's up from 1.75 during December 2018, 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 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 remain near record or cyclical highs for Communication Services, Consumer Discretionary, Information Technology, Real Estate, and Utilities. Financials and Health Care are rebounding from cyclical lows, while the remaining sectors are 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 two sectors now: Financials

and Utilities. 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 the sectors. Industrials is the only sector with its forward profit margin still at a record high. 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 (18.3, down from 19.2), Real Estate (15.7, down from 17.0), Communication Services (14.9, down from 15.4), Utilities (13.2, back at a record high), S&P 500 (12.0, down from 12.4), Health Care (10.5, down from 11.2), Industrials (10.5, a new record high this week), Materials (10.3, down from 11.6), Consumer Discretionary (7.4, down from 8.3), Consumer Staples (7.4, down from 7.7), and Energy (6.3, down from 8.0).

US ECONOMIC INDICATORS

CPI (*link*): November's core CPI rate remained above the Fed's 2.0% target rate, holding at 2.3% y/y, a tick below 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. November saw core prices rise 0.2% for the second month after increases of 0.1% and 0.3% the prior two months; the three-month rate slowed for the third month, to 2.1% (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 November from lowest to highest for goods: apparel (-1.6% y/y), used cars & trucks (-0.4), new vehicles (-0.1), alcoholic beverages (0.5), medical care commodities (0.6), and tobacco & smoking products (5.5)—with only the rate for medical care commodities on an accelerating trend. Here's the same drill for the core services rates: motor vehicle insurance (-0.2 y/y), physicians' services (1.4), airfares (2.0), motor vehicle maintenance & repair (3.2), hospital services (3.3), owners' equivalent rent (3.3), and rent of primary residence (3.7)—with both physicians' and hospital services rates on accelerating trends, along with airfares. The headline CPI rate moved above 2.0% for the first time since last November, accelerating for the second month, from 1.7% in September to 2.1% in November. It was at a recent high of 2.9% during June and July 2018.

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