MORNING BRIEFING
January 30, 2020

Content Wars

See the collection of the individual charts linked below.

(1) Crowded streaming market makes grabbing eyeballs harder. (2) Netflix growing fastest but spending more cash than it has. (3) Netflix says good-bye to departing *Friends* and relocating *Office*. (4) Competitors start hoarding content; Netflix responds by developing its own. (5) Comcast proud of Peacock; AT&T bets on HBO Now. (6) UK bids adieu to EU, now has lots to do. (7) UK's stock market lags other countries' in price performance and valuation.

Communications Services: Where To Watch TV. It was actor Alan Alda's birthday on Tuesday, according to a radio announcer who played a clip from the last episode of *M*A*S*H*. Alda played "Hawkeye," a playboy doctor who loved a martini and hated the war. The last episode was watched by 106 million people when it first aired in 1983. Such a huge number is incomprehensible today. Even last year's Super Bowl only drew 98 million viewers. Let's take a look at recent earnings reports from Netflix, Comcast, and AT&T to see how the three media giants are responding to consumers' changing tastes:

(1) *Netflix: Growing but bleeding cash.* Netflix continued to give the establishment a run for its money last quarter. The company increased its US subscriber count by 423,000 to 60.4 million in Q4. It also added 8.8 million subscribers overseas, bringing its worldwide total to 167 million.

The US results were below analysts' expectations, and the global results beat expectations. Netflix blamed the lower-than-expected US results on a recent price increase it pushed through to subscribers and new US competitors in the streaming market. Netflix forecasts adding 7.0 million global users (US and international) in Q1, down from the 9.6 million added a year ago.

Netflix's most recent season of its hit series *The Crown* was seen by 21 million households in its first four weeks and 73 million households have watched the series overall. But those are worldwide, not just US, viewers, so Hawkeye still wins the eyeball contest.

(2) *Worries about spending and defections*. Netflix reported a 31% y/y jump in Q4 revenue and $1.30 a share in earnings, which was boosted by a one-time tax adjustment. Bears like to focus on the company's free cash flow (fcf). It was a negative $1.7 billion in Q4 compared to negative $1.3 billion a year earlier. Netflix said 2019 will prove to be the year of peak negative fcf, at negative $3.3 billion compared to negative $2.5 billion in 2018. For this year, the company is forecasting fcf back at the negative $2.5 billion level.

Netflix is spending mightily on buying and creating content to show viewers. It spent $15 billion in cash on content during 2019, and investors were told to assume that capital expenditures will continue growing by 20% y/y as the company invests in creating more original content and buying less content from others. This spending is funded in the debt markets.

Some of the largest companies from which Netflix had purchased content in the past are now hoarding their content as they roll out their own streaming services. Comcast is rolling out Peacock, a streaming service, and plans to yank *The Office* from Netflix in 2021 and *Parks and Recreation* this year. *The Office* was the most watched Netflix show in 2018 (7.2% of all Netflix views), and *Parks* (2.3%) came in third, according to a 12/21/18 Vox article.

The second most watched show was *Friends* (4.1%), which left Netflix on 1/1 because its creator, WarnerMedia, is owned by AT&T; AT&T is launching a streaming service, HBO Max, over which *Friends* will stream. Then there's Disney's launch of Disney+. Disney used to stream its movies over Netflix one year after their release. But this year, that stops. Disney movies, such as "Captain Marvel," will be available only on Disney+.

In its 1/21 letter to investors, Netflix remained unperturbed: "Many media companies and tech giants are launching streaming services, reinforcing the major trend of the transition from linear to streaming entertainment. This is happening all over the world and is still in its early stages, leaving ample room for many services to grow as linear TV wanes. We have a big head start in streaming and will work to build on that by focusing on the same thing we have focused on for the past 22 years—pleasing members. We believe if we do that well, Netflix will continue to prosper."

Netflix's subscription adds may be slowing, but we'll be watching to see whether they reaccelerate when 5G is rolled out in upcoming years. Will consumers with 5G access stream Netflix content via their cell phone provider onto their televisions, cutting out cable companies'

Internet connections (and their cost) entirely?

(3) *Comcast: Leaning on the Internet.* Comcast added 442,000 high-speed Internet customers—a 26% increase—and lost 149,000 pay-TV customers in Q4, making it the 11th consecutive quarter of pay-TV subscriber losses, a 1/23 *WSJ* article noted. “Company executives have previously said Comcast won’t chase cable customers defecting to streaming apps. Instead, Comcast’s focus will remain on its broadband business and its investment in its streaming service, Peacock, on which it plans to spend $2 billion over the next two years,” the article stated.

Comcast will offer a limited version of Peacock for free, an ad-supported service for $4.99 a month, and a no-commercials version for $9.99. Comcast pay-TV subscribers and broadband subscribers will receive Peacock for free. Comcast has the cash to spend on this new area. In Q4, it generated $2.5 billion of fcf, and adjusted earnings rose 9.7% to 79 cents a share.

(4) *AT&T bets on HBO Max.* AT&T’s Q4 results weren’t pretty. The company lost cable and streaming TV subscribers, and its income only inched up. But worrying about that is so passé. AT&T shares are up roughly 20% over the past year. Investors are focused on the May introduction of HBO Max. In its content-stockpiling efforts, the company recently bought the rights to *The Big Bang Theory* as well as *Friends*.

HBO Max has a lot of heavy lifting to do. In Q4 alone, AT&T lost 945,000 satellite and fiber-optic TV subscribers, which brings its domestic TV subscriber base down to 20.4 million subscribers, less than Comcast’s 21.2 million video subs, noted a 1/29 *WSJ* article. Keeping its content for HBO Max—instead of licensing that content—hurt Warner Media’s revenue, which fell 3.3% to $8.9 billion.

All in all, AT&T’s revenue fell to $46.8 billion from $48.0 billion in the year-ago quarter, its adjusted operating income was $9.2 billion compared to $9.4 billion, and its adjusted EPS rose 3.5%. The company’s business does benefit from positive fcf, $8.2 billion in Q4, but it also has a mountain of debt, $151 billion, partially due to the $85 billion acquisition of Time Warner in 2018. The next year or two will determine whether that bet will pay off.

(5) *Entertaining numbers.* Disney and Netflix are members of the S&P 500 Movies & Entertainment stock price index, which is down 1.8% ytd through Tuesday’s close and up

12.4% y/y (*Fig. 1*). The industry is forecast to post strong revenue growth of 17.2% in 2020 and punk earnings growth of 2.0% in 2020 (*Fig. 2* and *Fig. 3*). Profit margins have narrowed sharply in the past two years, from 17.1% in 2018 to 11.2% currently (*Fig. 4*). Conversely, its forward P/E has expanded to 31.8 from 13.0 in 2018 (*Fig. 5*).

Comcast is a member of the S&P 500 Cable & Satellite stock price index, which is down 0.4% ytd and up 34.0% y/y (*Fig. 6*). The industry's revenues and profits have grown nicely in recent years. Revenue and earnings are each expected to climb 10.1% this year (*Fig. 7* and *Fig. 8*). Despite strong results, the industry's forward earnings multiple has fallen to 17.3 down from 24.4 in 2017 (*Fig. 9*).

AT&T belongs to the S&P 500 Integrated Telecommunication Services industry, which is down 2.3% ytd and up 15.3% y/y (*Fig. 10*). The industry has the slowest growth of the three industries we're discussing, with 2020 revenue forecast to climb 0.9% and earnings thought to increase 1.9% (*Fig. 11* and *Fig. 12*). The Integrated Telecom Services industry also has the lowest forward P/E, at 11.4 (*Fig. 13*).

Strategy: Bye-Bye, UK. After years of drama about whether, how, and when the United Kingdom should exit the European Union, the nation is finally going ahead with the separation on Friday. The UK stock market has lagged many other countries' stock markets since that fateful day in 2016 when 52% of voters opted to exit the EU. The UK MSCI has returned 17.4% in local currency and 3.8% in US dollars from 6/22/16 (the day before the Brexit vote) through Tuesday's close (*Fig. 14*).

The UK's local-currency stock market return since the Brexit vote is below the local currency returns of all the other European countries' MSCI indexes we track except for Greece's (-1.8%), and it's far behind the returns for the European Economic and Monetary Union (EMU) MSCI (18.9), the World MSCI (41.1), and the S&P 500 (57.1) (*Table 1*).

There's still much to be decided about the relationship between the UK and the EU (and US for that matter). In addition to trade agreements, the UK and EU have to hammer out how to handle law enforcement, data sharing and security, aviation standards, access to fishing waters, supplies of electricity and gas, and regulation for medicines, according to this 1/27 BBC primer. While we're waiting for those decisions, let's take a quick look at the UK's stock market fundamentals:

(1) *Lowered earnings expectations*. Analysts have been slashing their expectations for UK companies' earnings for the past two years. Over the past three months, for example, the net earnings revisions index (NERI) was negative in January (-12.5%), December (-14.8), and November (-13.3) (*Fig. 15*). That has left analysts targeting a drop in revenue of 1.4% in 2019 and an increase in 2020 of 1.2% (*Fig. 16*). Earnings are also expected to turn positive this year, up 6.8% in 2020 compared to a 4.5% drop in 2019 (*Fig. 17*). That makes the country's 2020 earnings growth among the slowest that we track (*Table 2*). Companies in the EMU are forecast to grow earnings 9.7%, those in the world 9.7%, and in the US 9.0%.

(2) *Lowered P/E too.* The forward P/E for companies in the UK's stock index has also tumbled from a high of 16.4 in early 2016 to a low of 11.2 in late 2018. The forward P/E currently stands at 13.3. That's lower than the forward P/E of the EMU (14.6) and the US (19.2) (*Fig. 18*). Within Europe, the UK's forward P/E is lower than both France's and Germany's forward P/Es (15.0 and 14.4) but higher than Italy's and Spain's (11.8 and 12.0) (*Fig. 19*).

CALENDARS

US: Thurs: Real GDP & PCE 2.2%/2.2%, GDP Price Index & Core PCED 1.8%/1.6%, Jobless Claims 214k, EIA Natural Gas Storage. **Fri:** Personal Income & Spending 0.3%/0.3%, Real Personal Spending 0.1%, Consumer Sentiment Index 99.1, Headline & Core PCED 1.6%/1.6% y/y, Employment Cost Index 0.7%, Chicago Purchasing Management Index 48.9 Baker-Hughes Rig Count. (DailyFX estimates)

Global: Thurs: Eurozone Economic Confidence 101.8, Eurozone Unemployment Rate 7.5%, Germany Unemployment Change & Unemployment Claims Rate 5k./5.0%, Germany CPI -0.6%m/m/1.7%y/y, Germany Sovereign Debt to be Rated by Moody's, UK Gfk Consumer Confidence -9, Japan Industrial Production 0.7%m/m/-3.6%/y/, Japan Retail Trade 1.2%m/m/-1.7%y/y, Japan Jobless Rate 2.3%, China M-PMI & NM-PMI 50.0/53.0, BOE Bank Rate 0.75%, BOE Asset Purchase Target £435b, Carney, Beaudry, Amamiya. **Fri:** Eurozone GDP 0.2%q/q/1.1%y/y, Eurozone Headline & Core CPI Flash Estimate 1.4%/12% y/y, Germany Retail Sales -0.5%m/m/4.5%y/y, France GDP 0.2%q/q/1.2%y/y, Italy GDP 0.1%q/q/0.3%y/y, Canada GDP, Japan Housing Starts 848k. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio dropped below 3.00 this week for the first time since 10/22/19, falling to 2.79 after climbing from 3.10 to 3.32 the prior two weeks. Once again, there were wide swings in bullish sentiment and the correction count, though bearish sentiment climbed just above the upper end of the range shown for most of 2019. Bullish sentiment sank 6.6ppts this week to 52.8% after rising 4.3ppts (to 59.4% from 55.1%) over the prior two-week period. The correction count jumped 5.6ppts, to 28.3%, following a 4.4ppts (22.7 from 27.1) slide the previous two weeks. Bearish sentiment (18.9 from 17.9) rose a percentage point this week to its highest percentage since 4/16/19. The AAII Ratio climbed for the second week last week to 64.8%, after a three-week slide from 68.3% to 52.5%. Bullish sentiment rose to 45.6% over the two-week period, after falling from 44.1% to 33.1% the prior three weeks, while bearish sentiment fell for the second week to 24.8%, after rising from 20.5% to 29.9% the previous three weeks.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): Consensus S&P 500 forward revenues and earnings both edged lower last week. Forward revenues remains near its record high a week earlier, and forward earnings is a tad below its record high in early January, which had been its first since early October. Analysts expect forward revenues growth of 4.8% and forward earnings growth of 9.2%. The revenues measure is down 0.1ppt w/w, and earnings dropped 0.2ppt. Forward revenues growth is at a 41-month low and 1.5ppt below its seven-year high of 6.3% in February 2018. Forward earnings growth is down 7.7ppts 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 4.1% in 2019 and 4.8% in 2020. They're calling for earnings growth to slow sharply from 24.0% in 2018 to 1.2% in 2019 before improving to 8.6% in 2020. The forward profit margin remained steady w/w at 12.0%, which is up 0.1ppt from a 22-month low of 11.9% in late December and is down only 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 0.3ppt y/y from 11.8% in 2018 to 11.5% in 2019 before improving to 11.9% in 2020. The S&P 500's forward P/E rose 0.2pt to an 18-year high of 18.8. That's up from 14.3 during December 2018, which was the lowest reading since October 2013 and down 23% then 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 gained 0.03pt w/w to a record high of 2.26. 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 rose w/w for five of the 11 S&P 500 sectors last week, and forward earnings was higher for six. Industrials had both measures fall markedly w/w, but three sectors had both measures rise: Consumer Staples, Financials, and Health Care. Forward revenues and earnings are at or around record highs for 3/11 sectors: Consumer Discretionary, Health Care, 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. Health Care's valuation has only recently improved from its multi-year low during December 2018. Due to the TCJA, the profit margin for 2018 was higher y/y for all sectors but Real Estate. All sectors except Real Estate are expected to record higher margins y/y in 2020, up from just two sectors improving y/y in 2019: 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 and Utilities are the only sectors with their forward profit margins still near 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 (18.2, down from 19.2), Real Estate (15.7, down from 17.0), Communication Services (14.8, down from 15.4), Utilities (13.3, back at a record high again), S&P 500 (12.0, down from 12.4), Health Care (10.5, down from 11.2), Industrials (10.3, down from its record high of 10.5% in mid-December), Materials (10.2, down from 11.6), Consumer Discretionary (7.4, down from 8.3), Consumer Staples (7.4, down from 7.7), and Energy (6.2, down from 8.0).

S&P 500 Q4 Earnings Season Monitor (*link*): Consensus forward revenues rose w/w for five of the 11 S&P 500 sectors last week, and forward earnings was higher for six. Industrials had both measures fall markedly w/w, but three sectors had both measures rise: Consumer Staples, Financials, and Health Care. Forward revenues and earnings are at or around record highs for 3/11 sectors: Consumer Discretionary, Health Care, 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. Health Care's valuation has only recently improved from its multi-year low during December 2018. Due to the TCJA, the profit margin for 2018 was higher y/y for all sectors but Real Estate. All sectors except Real Estate are expected to record higher margins y/y in 2020, up from just two sectors improving y/y in 2019: 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 and Utilities are the only sectors with their forward profit margins still near 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 (18.2, down from 19.2), Real Estate (15.7, down from 17.0), Communication Services (14.8, down from 15.4), Utilities (13.3, back at a record high again), S&P 500 (12.0, down from 12.4), Health Care (10.5, down from 11.2), Industrials (10.3, down from its record high of 10.5% in mid-December), Materials (10.2, down from 11.6), Consumer Discretionary (7.4, down from 8.3), Consumer Staples (7.4, down from 7.7), and Energy (6.2, down from 8.0).

US ECONOMIC INDICATORS

Pending Home Sales (*link*): The Pending Home Sales Index ended 2019 on a down note, with December sales dropping 4.9% to 102.3, as low inventory continued to impact sales. Still, December sales were up 4.6% y/y. Sales fell in every region last month, with the steepest declines occurring in the South (-5.5% m/m & 7.4% y/y) and West (-5.4 & 7.0)—though they're the two regions with the biggest yearly gains. Meanwhile, sales in the Northeast and Midwest fell 4.0% and 3.6% m/m, respectively, with sales in the former flat with a year ago and sales in the latter 1.3% above. According to Lawrence Yun, NAR's chief economist, "The state of housing in 2020 will depend on whether home builders bring more affordable homes to the market." He also mentioned that the new home construction market "looks brighter, with housing starts and new home sales set to rise 6% and 10%, respectively."

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