Yardeni Research

MORNING BRIEFING
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US Stocks With Immunity

Check out the accompanying audio excerpts and chart collection.

(1) Markets feeling better after shaking off the coronavirus. (2) Even the most sickly industries bounced on Wednesday. (3) Investors still loving FAANGMs and LargeCap Growth stocks. (4) Look, Ma, no steering wheel! Feds give first approval for autonomous car. (5) Nuro and many other players fighting for the autonomous vehicle delivery business. (6) Waymo's AV taxi service offering limited rides around Phoenix. (7) GM and Ford have a long road ahead. (8) Musk says AV coming, but playing defense on Autopilot crashes. (9) Chinese food prices soaring, while retail sales may fall to Earth.

Strategy: What Virus? The financial markets appear to have put the coronavirus in the rearview mirror. While the number of deaths continues to climb in China, the number of new cases has been declining, implying that officials have gained control of the situation.

The S&P 500, which briefly gave up January's impressive gains at the end of that month, has rebounded since and hit its fifth record high during February, leaving it up 4.6% ytd through yesterday's close (*Fig. 1*). The 10-year Treasury yield has also been climbing back from recent lows topping 1.63% on Wednesday (*Fig. 2*).

Most S&P 500 sectors have also bounced back nicely from the coronavirus scare. Here's the performance derby for the S&P 500 sectors ytd through Wednesday: Information Technology (10.8%), Utilities (6.7), Real Estate (6.3), Consumer Discretionary (6.1), Communication Services (5.2), S&P 500 (4.6), Industrials (4.5), Health Care (2.2), Consumer Staples (2.0), Financials (0.9), Materials (-1.2), and Energy (-9.1) (*Fig. 3*). Let's take a look at some of the winners and losers:

(1) *Tourism business down, but stocks bouncing.* The stock price indexes of industries involved with tourism rallied nicely on Tuesday and Wednesday, though most remain in negative territory ytd. Travel to and from China has screeched to a halt due to the virus. Cruise operators have canceled Chinese cruises, and the US has prohibited those in China from visiting the US. The travel industry could lose $5.8 billion in airfare and domestic spending this

year, according to estimates in a 2/12 *WSJ* article. Chinese spending on travel and tourism in the US was $34.6 billion in 2018.

The S&P 500 Hotels, Resorts & Cruise Lines stock price index is down 4.5% ytd, and the Casinos & Gaming stock price index has risen 1.3% through Wednesday (*Fig. 4* and *Fig. 5*). Meanwhile, the S&P 500 Airlines industry has also returned to positive ytd territory, 1.9%, through Wednesday (*Fig. 6*). In recent days, investors appear to have started looking past the virus-related problems.

(2) *Energy & Materials not reassuring*. The S&P 500's rally would be more convincing if the stock price indexes of certain economy-sensitive industries in the Energy and Materials sectors would return to positive territory. The price of gold, up 3.4% ytd through Tuesday, and the price of oil, down 18.2% (also through Tuesday), bear watching (*Fig. 7*). On Wednesday, the price of oil rallied, and the price of gold fell.

Here's how a smattering of the industries in the S&P 500 Energy and Materials sectors are performing ytd through Wednesday: Steel (-14.1%), Oil & Gas Exploration & Production (-10.4), Integrated Oil & Gas (-9.1), Diversified Chemicals (-4.5), Copper (-3.4), Specialty Chemicals (-2.9), Oil & Gas Drilling (-0.5), and Construction Materials (-2.9) (*Fig. 8*). They mostly rallied yesterday.

(3) *FAANGM love-fest continues*. The best-performing stocks in this market have been tech shares and Growth stocks as investors continue to clamor for FAANGMs (Facebook, Amazon, Apple, Netflix, Google, and Microsoft), as we discussed yesterday. LargeCap Growth stocks are up 7.8% ytd versus a 1.0% gain for LargeCap Value through Wednesday (*Fig. 9*). Meanwhile, the S&P 500 Internet & Direct Marketing Retail and Systems Software stock price indexes are the top performers since news of the coronavirus hit on 1/24, with returns of 12.5% and 10.0%, respectively, through Wednesday. SmallCap stocks aren't feeling the love, in either the Growth or Value investment-style categories. SmallCap Growth stocks are up only 2.7%, while SmallCap Value has fallen 3.1% through Wednesday (*Fig. 10*).

Disruptive Technologies: Autonomous Vehicles Accelerating. Can you imagine a day when autonomous cars become so common that teenagers no longer have to learn how to drive? Future parents will miss all the white-knuckle fun of phantom-braking from the passenger seat!

The autonomous era is slowly creeping closer. Last week, Nuro received the first approval from federal regulators to operate driverless delivery vehicles. Not far behind are many other traditional players testing autonomous vehicles (AVs) carrying deliveries and humans. Here's Jackie's roundup of some of the latest news:

(1) *Nuro takes the lead.* When driving regulations were written, it was presumed that a human would be behind the wheel. So many of the laws on the books are silent about whether autonomous cars are legal or not. Some states have written laws or governors have signed executive orders that have encouraged the testing and use of AVs. But others haven't done so, leaving a patchwork of legislation across the country.

That changed for one company last week. Nuro became the first company to receive an exemption from the US Department of Transportation and the National Highway Traffic Safety Administration. The decision allows the company to operate R2, vehicles that don't have a driving wheel or other items a traditional car has, according to a 2/6 blog post in Medium written by Nuro co-founder Dave Ferguson.

The Nuro R2 is a cross between a car and a robot. It has a maximum speed of 25 miles per hour and drives on roads. However, it doesn't have a steering wheel, pedals, or rearview mirrors. The battery-powered vehicle is meant to deliver things, not people. It's roughly the same height as a car, but about half the width and about half the weight. Regulatory approval for larger, heavier vehicles is expected to be tougher.

Nuro will begin public road testing the R2 in Houston in the coming weeks, delivering items for partners including Walmart, Domino's, and Kroger. The R2's cab space is temperature controlled, so it can keep milk cold and pizza warm. Customers can follow the R2's delivery progress on an app; they receive a code that opens the delivery compartment of the R2 to retrieve their delivery.

Nuro, which has raised more than $1 billion from investors including Softbank, had been testing an earlier version of its AV—the R1—in Scottsdale, Arizona.

(2) *Eggs not all in one basket*. Nuro's partners have pilot programs going on with other companies too. According to a 10/10/19 Techcruch article, Walmart "earlier this year tapped the startup Udelv to test autonomous grocery deliveries in Arizona. This summer, it kicked off a test with Gatik, AI, an AV startup to test grocery delivery from Walmart's main warehouse in

Bentonville, Ark. Walmart also launched a pilot with self-driving company Waymo in 2018 to test rides to Walmart for grocery pickup, as well as a test with Ford and Postmates for autonomous grocery delivery." Likewise, Dominos had worked with Ford's autonomous cars in Michigan.

(3) *Waymo AVs in Phoenix.* Waymo, a division of Google, started offering some truly autonomous taxis in Phoenix in October. These vehicles don't have safety drivers but do have safety features that limit their operation to certain suburbs at certain times of the day, and never during dust storms.

For the previous two years, Waymo had been testing its AVs with safety drivers behind the wheel, which some of its test cars still will have. For instance, safety drivers will be in the Waymo AVs that deliver packages from some Arizona UPS stores to a UPS hub as part of a partnership the two companies announced last month.

(4) *Ford and GM in the slow lane.* Ford and GM are trying to keep up with the auto industry's upstarts. Ford is mapping the streets of Austin and hopes to launch an autonomous taxi and delivery service in 2021, according to a 9/25/19 article in The Verge. However, its vehicles aren't currently fully autonomous. Two safety human drivers are in each vehicle.

Ford has also tested its autonomous cars in Miami, Detroit, Washington, DC, and Pittsburgh. It has been using a Ford Fusion decked out with all the necessary equipment. The company uses software developed by Argo AI, a startup into which Ford has invested $1 billion, and it has announced a major partnership with Volkswagen, which will invest an additional $2.6 billion into Argo.

GM has been testing self-driving autonomous Chevy Bolts in San Francisco, Arizona, and Michigan and had hoped to launch a robot taxi service in San Francisco by the end of last year. But that deadline wasn't met, and a new deadline wasn't announced.

GM's Cruise division does have a new AV, dubbed "Origin," that it expects will be used in a ride-sharing fleet. "Inside are two bench seats facing each other, a pair of screens on either end ... and nothing else. The absence of all the stuff you expect to see when climbing into a vehicle is jarring. No steering wheel, no pedals, no gear shift, no cockpit to speak of, no obvious way for a human to take control should anything go wrong," a 1/21 article in The Verge reported.

GM owns two-thirds of Cruise. The remainder of the equity is owned by Honda—which is investing $2.75 billion in the company over 12 years—SoftBank, and T Rowe Price. The excellent Verge article contained an eyepopping figure: These cars can cost from $300,000 to $400,000 each because of the software and sensors they require!

(5) *Musk's big promises.* Tesla's cars already come with Autopilot, meant for highway driving, but drivers are told to remain in control of their vehicles. The company's cars also offer Smart Summon, which permits drivers to turn on their cars remotely and drive from a parking spot to the driver.

But Elon Musk is promising bigger things. He says the company's cars will "soon" offer "full self driving," which makes it possible for a car to drive itself from one's home in the suburbs onto the highway and into the city. He also has a goal of deploying 1 million robotaxis this year, and within two years he predicts the company will make cars with no steering wheels or pedals, a 12/19/19 CNBC article reported.

That said, the National Transportation Safety Board is investigating an accident in 2018 and one in 2019 where Tesla drivers crashed while their Autopilot was on, a 2/11 *US News & World Report* article reported. Headlines like that don't help Tesla or any of the players in the AV industry.

China: Feverish Food Inflation Readings. On Monday, we learned that China's CPI inflation rate jumped to 5.4% y/y during January, up from 4.5% in December (*Fig. 11*). January's reading was the highest since October 2011. It was led by soaring food prices. Excluding food, it was only 1.6%.

Food prices jumped 20.6% y/y during January—the most since April 2008—led by a 76.7% increase in the meats component of the CPI (*Fig. 12*). Since early last year, pork prices have soared as a result of the swine flu, which decimated China's pig herds. Pork prices jumped 116% y/y during January. The coronavirus, which led the government to impose drastic measures to contain the outbreak, occurred in late January. It is bound to worsen food inflation in China since some food supplies may spoil before shipping to large cities due to the disruption of transportation and other lockdown measures, especially for fruits, vegetables, and livestock.

Inflation-adjusted retail sales growth in China is likely to drop to zero on a y/y basis, as many consumers are confined to their homes and have to spend more on food.

CALENDARS

US: Thurs: Headline & Core CPI 2.5%/2.2% y/y, Jobless Claims 210k, EIA Natural Gas Storage, Williams. **Fri:** Retail Sales Total, Ex Autos, Ex Autos & Gas, and Control Group 0.3%/0.3%/0.3%/0.3%, Consumer Sentiment Index 99.2, Business Inventories 0.1%, Headline & Manufacturing Industrial Production -0.2%/0.0% m/m, Capacity Utilization 76.8%, Import Price Index -0.2%m/m/0.1%y/y, Baker-Hughes Rig Count, Mester. (DailyFX estimates)

Global: Thurs: Germany CPI -0.6%m/m/1.7%y/y, Mexico Overnight Rate 7.00%, European Commission Publishes Winter Forecast, Lane, Panetta. **Fri:** Eurozone GDP 0.1%q/q/1.0%y/y, Eurozone Trade Balance €19.0b, Eurozone Employment, Germany GDP 0.1%q/q/0.4%y/y, China New Yuan Loans & Aggregate Financing ¥3.10t/ ¥4.25t. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) rose for the first time in three weeks, though remained below 3.00 for the third straight week. The BBR climbed to 2.76 this week after falling from 3.32 to 2.49 the prior two weeks. The seesaw movement between the bullish and correction camps continued: This week, bullish sentiment rebounded 5.3ppts to 52.9%, after falling 11.8ppts (to 47.6% from 59.4%) the prior two weeks and rising 4.3ppts the two weeks before that. Meanwhile, the correction count sank 5.4ppts this week to 27.9%, following a two-week surge of 10.6ppts (33.3 from 22.7) and a two-week loss of 4.4ppts. Bearish sentiment climbed 1.4ppts to 19.2% the past four weeks—its highest percentage since 4/16/19. The AAII Ratio advanced to 49.0% last week after dropping from 64.8% to 46.5% the previous week, as bullish sentiment rose from 32.0% to 33.9% and bearish sentiment fell from 36.9% to 35.2%.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): Consensus S&P 500 forward revenues and earnings both rose w/w to record highs. Analysts expect forward revenues growth of 4.9% and forward earnings growth of 8.6%. The revenues measure was steady w/w, but earnings dropped 0.4ppt. Forward revenues growth is 0.1ppt above its 41-month low a week earlier and 1.4ppt below its seven-year high of 6.3% in February 2018. Forward earnings growth is down 8.3ppts 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 4.2% in 2019 before improving to 4.9% in 2020. They're calling for earnings growth to slow sharply from 24.0% in 2018 to 1.6% in 2019 before improving to 7.8% 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 11.8% in 2020. The S&P 500's forward P/E rose 0.3pt w/w to match its recent 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 rose 0.03pt w/w, to also match its recent 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 and earnings rose w/w for seven of the 11 S&P 500 sectors last week. Energy and Materials posted notable decreases w/w. 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 Health Care and 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. Utilities is the only sector with its forward profit margin 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 (22.1%, down from 23.0%), Financials (18.1, down from 19.2), Real Estate (15.8, down from 17.0), Communication Services (14.9, down from 15.4), Utilities (13.4, new record high this week), S&P 500 (12.0, down from 12.4), Health Care (10.5, down from 11.2), Industrials (10.0, down from its record high of 10.5% in mid-December), Materials (9.9, down from 11.6), Consumer

Staples (7.5, down from 7.7), Consumer Discretionary (7.4, down from 8.3), and Energy (6.1, down from 8.0).

GLOBAL ECONOMIC INDICATORS

Eurozone Industrial Production (*link*): Output tumbled at the end of 2019, plunging to its lowest reading since May 2016. Production sank 2.1% in December—its biggest monthly decline since February 2016, recording only one gain during the final seven months of last year. Production dropped 4.1% y/y—matching its steepest decline since November 2009. Output in all major industrial groupings fell on a monthly basis, while only consumer nondurable goods production was in the plus column on a yearly basis—here's a look: capital goods (-4.0% m/m & -6.7% y/y), intermediate goods (-1.7 & -5.5), consumer durable goods (-1.1 & -1.4), energy (-0.5 & -2.3), and consumer nondurable goods (-1.3 & 1.3). Of the top four Eurozone economies, all posted sizable declines on both a monthly and yearly basis in December, except for Spain, which was flat y/y: Germany (-2.5% m/m & -7.2% y/y), France (-2.9 & -3.2), Italy (-2.7 & -4.3), and Spain (-1.5 & 0.1)—with Germany's the third-weakest among the Eurozone economies on a y/y basis.

UK GDP (*link*): Real GDP growth expanded 0.3% in December after contracting 0.3% in November, recording its best monthly showing since July. December's increase was led by swings from contraction to expansion for both services (to 0.3% from -0.4) and manufacturing (0.3 from -1.6). However, December's improvement was not able to jumpstart Q4 growth—which flatlined last quarter. During Q4, gains in construction (0.5%) and services (0.1) were offset by a 0.8% drop in production industries, led by manufacturing (-1.1)—which was driven lower by declines in motor vehicles. For all of 2019, real GDP expanded 1.4%, up from 1.3% during 2018. A 2.5% gain in construction, along with a 1.8% advance in services, more than offset the 1.3% drop in production industries—driven by a 1.5% contraction in manufacturing.

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