



MORNING BRIEFING

May 14, 2020

Bumpy Road for Transports

Check out the accompanying [chart collection](#).

(1) Powell to politicians: Be ready to step up. (2) Transports sending bearish signals. (3) Trucking one of few industries in positive ytd territory. (4) May railroad data show deterioration continues. (5) Investors help trucking and railroads stocks bounce, but still avoiding airlines. (6) April numbers out of China show economy starting to percolate. (7) Marriott says Chinese consumers starting to travel again. (8) Under Armour Chinese stores open, but sales still down y/y. (9) Will US follow China's economic trajectory?

Strategy I: Tossing the Ball to DC. Fed Chair Jerome Powell reminded Wall Street that its worst nightmare might come true: The economy's future may depend on politicians. In a [presentation](#) Tuesday to the Peterson Institute for International Economics, Powell quite bluntly warned that the future is "highly uncertain and subject to significant downside risks." Additionally, he said politicians may need to step up and spend more to support companies until the economy recovers from the Great Virus Crisis.

Powell highlighted the importance of supporting small and medium-sized businesses—a principal source of job creation—as their demise could limit the strength of the recovery. "Additional fiscal support could be costly, but worth it if it helps avoid long-term economic damage and leaves us with a stronger recovery. This tradeoff is one for our elected representatives, who wield powers of taxation and spending," he said.

The comments were disturbing because just one day earlier Democrats and Republicans showed that they were football fields apart on whether more spending was necessary and, if so, where funds should be spent. The House Democrats proposed on Monday a \$3 trillion spending bill that contained little to which any Republican would agree. Meanwhile, Republicans let it be known that they were in no hurry to provide any additional funding. A May 12 [WSJ article](#) quoted a top White House economic adviser saying the administration was in "wait and see" mode on the next round of aid.

As you'd expect, the riskiest sectors sold off the hardest on Tuesday, but no sector was spared. Here's yesterday's performance derby for the S&P 500's sectors: Consumer Staples (-0.9%), Utilities (-0.9), Health Care (-1.1), Consumer Discretionary (-1.2), Real Estate (-1.6), Communication Services (-1.6), Information Technology (-1.7), S&P 500 (-1.8), Materials (-2.2), Industrials (-2.6), Financials (-3.0), and Energy (-4.4).

Amid the gloom, there was some good news yesterday. Certain areas of New York and New Jersey were given the green light to partially reopen. Northern areas of New York State will allow construction, manufacturing, agriculture, forestry, fishing, and retail for curbside or in-store pickup. The sports deprived will be glad to learn that the German soccer league starts playing games on Saturday, NASCAR is holding a race in South Carolina on Sunday, and there's a charity golf match with Rory McIlroy in Florida on Sunday. While in-person spectators aren't allowed and the Yankees' season remains on hold, at least things are moving in the right direction.

Strategy II: Transports Running on Fumes? One area of the stock market that's still throwing off worrisome signals is Transports. The S&P 500 Transportation stock price index remains down 24.1% ytd through Tuesday's close. That's an improvement from March 23, when it was down 36.1%, but it's more than double the S&P 500's 11.2% drop over the same period.

The S&P 500 Transportation index has been dragged down by the 63.2% ytd decline in its airlines industry component, as few people are traveling due to the COVID-19 outbreak. Without the airlines, the S&P 500 Transportation index would be down only 14.7% ytd, more in line with the broader index's performance.

Here's how the other members of the S&P 500 Transportation index have performed ytd through Tuesday's close: Trucking (5.6%), Railroads (-13.8), and Air Freight & Logistics (-19.4). Let's take a look at some industry-specific factors that will shape the sector's path going forward.

(1) *Trucking is driving in positive territory.* The S&P 500 Trucking stock price index is up 5.6% ytd through Tuesday's close, making it the ninth best-performing industry we track ([Fig. 1](#)). The index has rebounded since March 16, when it was down by 24.3% ytd.

Trucking's ytd gain puts this industry in scarce company. Only 15 S&P 500 industries' stock price indexes are in positive territory ytd, and most of those are either tech related or very defensive. Here's the performance derby of the top-performing S&P 500 industries ytd: Gold (43.8%), Internet & Direct Marketing Retail (20.3), Food Retail (15.7), Systems Software (15.2), Interactive Home Entertainment (14.8), Biotechnology (9.7), Internet Services & Infrastructure (9.4), Application Software (8.8), Trucking (5.6), Hypermarkets & Food Super Centers (4.0), Financial Exchanges & Data (3.6), Technology Hardware, Storage & Peripherals (3.0), Home Improvement Retail (2.8), Interactive Media & Services (2.4), and Specialized REITs (0.4).

Trucking stocks appear to be anticipating a rebound in shipping volumes as states reopen for business. The ATA truck tonnage index enjoyed a nice jump, up 2.2% during the two months through March, after falling fairly steadily from July through January by the same amount ([Fig. 2](#)). However, the index will likely fall in April given that trucking companies report volumes fell during the first weeks of April as COVID-19 stay-at-home orders were enforced.

Trucking company YRC Worldwide reported that less-than-truckload volume was down 2.4% in February, down 11.3% in March, and down 23.9% in April according to preliminary results, CFO Jamie Pierson said on YRC's May 11 Q1 earnings [conference call](#). He sounded a more optimistic note about more recent results: "[B]ased on our most recent three to four weeks actual experience, volumes appear to have stabilized and with the states lifting those orders, we are hopeful that, we will begin to see some positive sequential moves in the coming weeks, if not months."

That said, operators weren't confident enough to run out and buy new trucks. Medium- and heavy-weight truck sales have plunged 55% since September's record high ([Fig. 3](#)). The only silver lining is for the customers of trucking services, as the price to ship by truck declined by 1.4% y/y in April, a dramatic change from mid-2018 when prices were rising by roughly 8% y/y ([Fig. 4](#)).

The S&P 500 Trucking industry's revenue is forecast to drop 4.4% this year and rise by 9.1% in 2021 ([Fig. 5](#)). Earnings are projected to follow a similar path, dropping an estimated 14.4% this year and rebounding by 24.8% in 2021 ([Fig. 6](#)). As earnings forecasts have been cut sharply, the industry's forward P/E has jumped to 26.2 ([Fig. 7](#)).

(2) *Railroads are paused at a crossing.* Railroad data are more current than trucking data and reflect the damage that COVID-19 has wreaked on the economy. Railcar loadings are down 9.0% ytd through May 9 ([Fig. 8](#)). Since peaking in late 2018, both carload and intermodal railcar loadings have fallen ([Fig. 9](#)).

Intermodal loadings have been under pressure since last year, first due to the Trump administration's trade war with China and now due to the COVID-19 global economic slowdown and excess capacity in the trucking industry. Union Pacific noted that domestic intermodal traffic fell 5% in Q1, while international intermodal volume dropped 24% in the quarter. Intermodal traffic has trailed the slowdown in real exports and real imports nicely ([Fig. 10](#)).

The railroads face some headwinds that don't hurt the trucking industry as badly. The shutdown of automobile manufacturing has hurt the railroad industry, with motor vehicles loadings down 22% since mid-March ([Fig. 11](#)). The industry has also come under pressure from the sharp decline in the price of oil and drop in oil well activity ([Fig. 12](#)). And then there is the decline in the use of coal that has resulted in fewer coal shipments by rail for the last decade ([Fig. 13](#)).

Union Pacific's Q2 car loadings were down 22% as of April 23, and "volumes for the full quarter could be down around 25% or so," CFO Jennifer Hamann said in the railroad's Q1 [conference call](#). Analysts have slashed revenue and earnings estimates for the S&P 500 Railroad industry since late 2019. Revenue for the industry is expected to drop 11.4% this year and rise 8.0% in 2021 ([Fig. 14](#)). Likewise, earnings are now expected to drop 11.6% this year and jump 19.4% next year ([Fig. 15](#)). Investors seem to be looking out to next year because the S&P 500 Railroad stock price index, which was down 36.5% ytd through March 23, has rebounded and is now down only 13.8% ytd through Tuesday's close ([Fig. 16](#)).

(3) *Airlines are in a nosedive.* The damage COVID-19 has done to the airlines industry cannot be understated. Global commercial departures around the world during the first full week of April declined to 287,760 flights, down almost 60% from the first full week of December, an April 22 Business Insider [article](#) reported. The drop in traffic was similar in North America, where there were 102,319 departures during the first week of April compared to 198,290 during the first week of December.

While horrific, those numbers actually underreport the damage because many airlines are flying nearly empty planes. The number of travelers passing through US security checkpoints fell to 95,000 on April 16, down from nearly 2.3 million travelers on March 1 and 2.6 million on April 16, 2019—a 96.3% decline.

The damage to the industry is so great that investors haven't been willing to bet on a rebound in 2021, as they have been willing to do with other industries. The S&P 500 Airlines industry stock price index remains at its 52-week low and is the S&P 500's second worst-performing industry group. It has fallen 63.2% ytd, beating the S&P 500 Department Stores stock price index by only 0.4ppt ([Fig. 17](#)). Revenue is forecast to plummet 51.7% this year, and earnings are forecast to dive to a record loss. Analysts do see revenue rebounding by 59.0% in 2021 and earnings soaring back to a profit as well ([Fig. 18](#) and [Fig. 19](#)).

Despite the industry's poor performance, famed Value investor Bill Miller is sticking with his airlines trade. He [told](#) CNBC on Tuesday that those who don't own stocks in the industry are "making a bet against the vaccine."

China: First In, First Out. With China's April economic data trickling out, we're starting to get a look at what a post-COVID economic recovery might look like in the US. So far, the data show a sharp bounce in manufacturing and continued recovery in the stock market. China's recovery has also been noted by some CEOs of US-based multinationals with production or sales operations in China. Here's hoping that the country's recovery continues and that the US economy follows the same trajectory. I asked Jackie to take a look at both the data and the US CEOs' recent comments:

(1) *April data show progress.* With COVID-19 shutdowns hopefully in the past, China's factories are back in business. China's manufacturing slowed a touch in April but continued to expand. China's Purchasing Managers Index (PMI) for manufacturing was 50.8 last month, down from 52.0 in March but up from the low of 35.7 in February ([Fig. 20](#)). The country's non-manufacturing PMI also rose in April, to 53.2 from 52.3 in March and a record low of 29.6 in February ([Fig. 21](#)).

A rebound in auto sales helped the manufacturing numbers. April auto sales rebounded to 2.1 million units, up from the low of 0.3 million units in February but still off of the recent peak of 2.7 million units in December ([Fig. 22](#)). One data point that doesn't reinforce the country's

rebound is China's continued decline in imports. April imports fell 11.5% y/y, while exports rose 2.9% y/y ([Fig. 23](#)).

China's stock market has also enjoyed a recovery lately, making it one of the top performers in the world ytd. The MSCI China stock price index in yuan is down just 4.5% ytd through Tuesday's close and roughly halfway between its recent lows and 2019 peak ([Fig. 24](#)).

(2) *Hotels open in China.* COVID-19 has decimated Marriott's business. Revenue per available room (RevPAR) fell 90% y/y in April worldwide and in North America. April system-wide occupancy was 12%, with about 25% of hotels temporarily closed. But the company is seeing improvement in China.

"The resiliency of demand is evident in the improving trends in Greater China. New bookings continue to pick up with demand driven primarily by domestic travelers," said CEO Arne Sorenson during Marriott's Q1 May 11 [conference call](#). "Occupancy levels in Greater China are currently just over 30%, up from the lows of under 10% in mid-February. RevPAR has followed a similar trajectory, currently down around 67% year-over-year compared to an 85% decline in February. Throughout Mainland China, leisure demand was strong for the Chinese Labor Day holiday weekend in early May. Occupancy for that weekend was over 45% with resort markets close to 70%."

(3) *Selling hoodies in China.* More than 80% of Under Armour stores in China—both company-owned and owned by partners—had reopened by the end of March and now nearly all have reopened, CEO Patrik Frisk said during the company's May 11 earnings [conference call](#).

"[T]raffic in these locations, while continuing to see progressive recovery in recent weeks, continues to be down year-over-year," he said. "[T]he good news is ... that the consumer is coming back. I think the bad news is that it's taking a little longer than we would wish." The other piece of bad news is that 80% of the company's global business remains shut down, and Q2 revenue could drop as much as 60% after Q1 revenue fell 23%.

CALENDARS

US: **Thurs:** Jobless Claims 2.5m, Import Prices -3.1% y/y, EIA Natural Gas Storage, Kaplan, Kashkari. **Fri:** Retail Sales Total & Ex Autos -12.0%/-8.6%, Consumer Sentiment Index 68.0, JOLTS, Headline & Manufacturing Industrial Production -11.5%/-13.0%, Capacity Utilization

64.0%, Empire State Manufacturing Index -63.5, Business Inventories -0.2%, Baker-Hughes Rig Count. (DailyFX estimates)

Global: **Thurs:** Germany CPI 0.3%_{m/m}/0.8%_{y/y}, France Unemployment Rate 8.4%, China Retail Sales -7.0% _{y/y}, China Industrial Production 1.5% _{y/y}, China Unemployment Rate, Japan Machine Tool Orders, ECB Economic Bulletin, Guindos. **Fri:** Eurozone GDP -3.8%_{q/q}/-3.3%_{y/y}, Germany GDP -2.2%_{q/q}/-2.0%_{y/y}. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): The Bull/Bear Ratio (BBR) rose again this week, and was above 1.00 for the fifth week, after three weeks below. The BBR climbed for the seventh straight week, to 1.81, after falling from 2.89 to 0.72 (the lowest since February 2016) the prior five weeks. Bullish sentiment took a small step back, ticking down to 47.1% after advancing the prior six week by 18.0ppts (to 48.1% from 30.1%), following a five-week plunge of 24.6ppts (to 30.1% from 54.7%)—to its lowest percentage since late December 2018. Meanwhile, bearish sentiment has dropped 15.7ppts the past seven weeks to 26.0%, after shooting up 22.8ppts (41.7 from 18.9) the previous five weeks. The correction count is up 2.6ppts the past two weeks to 26.9%, after dropping 8.0ppts the prior four weeks (to 24.3% from 32.3%). The AAll Ratio fell to 31.0% last week after increasing from 33.2% to 41.0% the prior week, as bullish sentiment fell from 30.6% to 23.7% and bearish sentiment rose from 44.0% to 52.7%.

S&P 500 Earnings, Revenues, Valuation & Margins ([link](#)): Analysts slowed their pace of COVID-19 estimate cuts during the latest week. The S&P 500's consensus annual revenues and earnings forecasts continued to fall, but forward revenues was only down a little while forward earnings rose. The consensus S&P 500 forecasts had been falling at rates that paralleled the declines during the financial crisis of 2008-09. Forward revenues edged down less than 0.1% _{w/w} to its lowest level since June 2018 and is now 7.3% below its record high in mid-February. Forward earnings rose 0.4% _{w/w} from its lowest level since October 2017 and is now 20.0% below its record high in early March. Forward growth forecasts rose _{w/w} too. Analysts expect forward revenues growth of 0.8% and a forward earnings decline of 2.8%. The revenues growth measure was up 0.6ppt _{w/w}, and earnings growth gained 2.8ppts. Forward revenues growth is up from the lowest reading since June 2009 and 5.6ppts below its seven-year high of 6.3% in February 2018. Forward earnings growth is up from its record low a week earlier, but remains 19.7ppts below its six-year high of 16.9% in February 2018. 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%. Annual growth expectations for 2020 continue to deteriorate. Analysts expect revenues to decline 4.8% y/y in 2020 compared to the 4.2% reported in 2019. That's down 0.7ppts w/w and 9.7ppts since the start of the year. They're calling for earnings to decline 21.5% y/y in 2020 compared to a 1.5% rise in 2019. The 2020 growth rate fell 1.6ppt w/w and is down 30.5ppt since the beginning of the year. The forward profit margin of 10.3% was steady w/w at the lowest level since August 2013, but is down 2.1ppt 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 the prior cyclical low of 10.4% in March 2016. Analysts now expect the profit margin to fall 2.1ppt y/y in 2020 to 9.5%—from 11.6% in 2019—and to improve 1.8ppt y/y to 11.3% in 2021. Valuations have been extremely volatile on both a daily and weekly basis; they fell last week for the first time in seven weeks. The weekly snapshot of the S&P 500's forward P/E was down to 20.1 from 20.8, which had been the highest since March 2002 and up from a 77-month low of 14.0 in mid-March. It's still well above the 14.3 bottom during the December 2018 selloff (that 14.3 bottom 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 to 2.08 from a 10-week high of 2.14. That's still up from the 49-month low of 1.65 in mid-March, which compares to mid-February's record high of 2.29. It's now back above the 1.75 trough during the December 2018 selloff, 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 fell w/w for six of the 11 sectors, and forward earnings was lower for five sectors. Health Care and Tech had both measures rise w/w, while Consumer Staples and Materials had both fall. Due to sharply lower forward earnings, forward P/E ratios for most sectors are now back above the recent record or cyclical highs prior to the bear market, but forward P/S ratios remain below their highs. Utilities is the only sector expected to record higher margins y/y in 2020, down from eight expected to do so in early March. During 2019, just two sectors improved y/y: 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. However, four rose and four fell during the latest week. 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 (21.7%, down from 23.0%), Real Estate (14.7, down from 17.0),

Communication Services (13.4, down from 15.4), Utilities (13.9, new record high this week), Financials (13.3, down from 19.2), S&P 500 (10.3, down from 12.4), Health Care (10.1, down from 11.2), Materials (8.9, down from 11.6), Industrials (7.5, down from its record high of 10.5% in mid-December), Consumer Staples (7.2, down from 7.7), Consumer Discretionary (5.1, down from 8.3), and Energy (0.6, down from 8.0).

Consensus 2020 Revenue & Earnings Changes ([link](#)): Over the 15 weeks since the virus hit the news—i.e., from January 23 to May 7—the 2020 revenue forecast for the S&P 500 has dropped 9.6%, and the index's earnings forecast has tumbled 27.4%. Revenue and earnings forecasts for the broader MSCI United States, which includes midcap-sized companies, are down a lesser 8.5% and 26.5% in part due to limited visibility for the midcaps. For MSCI China, revenue forecasts are down 9.4%, but earnings are down only 13.4% because profit margins for the country are relatively low compared to the rest of the world. The following countries have been hit particularly hard: Greece (revenue down 35.1%, earnings down -38.8%), Ireland (-15.8, -29.5), Italy (-10.6, -37.6), Portugal (-13.2, -23.5), and Russia (-23.7, -38.7). Here's how the MSCI World and regional indexes stack up in US dollar terms: World (revenues down 9.1%, earnings down 26.0%), World ex-US (-10.2, -26.2), (EMU -8.9, -33.3), Europe (-12.9, -33.4), Emerging Markets (-12.1, -22.7), EM Asia (-9.8, -17.0), and EM Latin America (-26.5, -43.9). Keep in mind, the results are slightly better in local-currency terms. Within the US, the following S&P 500 industries and sectors are now forecasted to report a loss in 2020: Airlines, Automobile Manufacturers, Casinos & Gaming, Copper, Department Stores, the Energy sector, Hotels, Hotels & Resort REITs, Integrated Oil & Gas, Oil & Gas Drilling, Oil & Gas Equipment & Services, Oil & Gas Exploration & Production, and Oil & Gas Refining & Marketing. The outlook is particularly dire for Oil & Gas Drilling, which is expected to report losses through 2022.

US ECONOMIC INDICATORS

Producer Price Index ([link](#)): The Producer Price Index for final demand posted a record 1.3% drop in April, following declines of 0.2% and 0.6% the prior two months. The recent declines pushed the yearly rate into negative territory for the first in four years, to -1.2% y/y; it started the year at an eight-month high of 2.1%. Final demand goods accounted for April's sharp drop, with these prices plunging a record 3.3%—after declines of 1.0% and 0.9% during March and February, respectively. Two-thirds of April's decline can be traced to a 56.6% plunge in gasoline prices—which is the largest decline since the series began in February 1947. The yearly rate sank to a five-year low of -5.0% y/y from a recent peak of 1.8% at the start of this

year. Meanwhile, prices for final demand services dipped 0.2% last month after a 0.2% gain and a 0.3% loss the previous two months; its yearly rate has eased from 2.0% at the start of the year to 0.8% y/y in April—the lowest since the end of 2015. In the meantime, there's still deflation in the pipeline: Intermediate goods prices fell 7.3% y/y in April, the sharpest since November 2015 (and its 12th consecutive negative reading), while crude prices fell 28.2% y/y (its 16th consecutive negative reading)—the steepest decline since September 2009.

GLOBAL ECONOMIC INDICATORS

Eurozone Industrial Production ([link](#)): Shutdowns due to the coronavirus generated the biggest monthly decline in industrial production in the history of the series going back to 1991. Output plunged 11.3% in March, tumbling to its lowest level since fall 2009. The weakness was across the board, led by double-digit losses in production of consumer durable (-26.3%), capital (-15.9), and intermediate (-11.0) goods; declines in energy (-4.0) and consumer nondurable goods (-1.6) output were in the low single digits. Of the top four Eurozone economies, Italy (-28.4) posted the largest decline in production among the Eurozone economies in March, with France (-16.4) recording the third largest loss. Spain and Germany weren't too far behind France, tumbling 11.9% and 11.2%, respectively. Meanwhile, Ireland (15.5) was the top performer among the Eurozone countries, with Greece (1.9) finishing number two.

UK GDP ([link](#)): The UK warned of a “significant” slowdown in economic growth following the release of the GDP numbers on Wednesday. Real GDP plunged a record 5.8% in March, as the coronavirus spread and the UK economy was put on lockdown. March's drop caused a 2.0% decline in economic growth during Q1—the biggest contraction since late 2008, during the depths of the financial crisis. March's freefall was felt in all major sectors, with record monthly declines turning quarterly growth rates negative: services (-6.2% m/m & -1.9% q/q), construction (-5.9 & -2.6), and production (-4.2 & -2.1). The production sector includes manufacturing, which saw growth sink 4.6% in March—the steepest since mid-2002—with the quarterly rate sliding 1.7%. UK's finance minister warned that the UK was in the midst of a significant recession and added: “We have to support people's jobs, their incomes, livelihoods at this time, and support businesses so we can get through this period of severe disruption and emerge stronger on the other side.”

UK Industrial Production ([link](#)): COVID-19 has precipitated the biggest monthly decline in the UK's industrial production since the late 1970s. Output tumbled 4.2% in March, with factory

production contracting 4.6%. Industrial groupings show capital goods (-10.1%) posted the steepest drop in production in March, with output of consumer durable goods (-3.9), energy (-3.8) and intermediate goods (-3.6) all showing similar declines. Meanwhile, consumer nondurable goods production rose 2.1% during the month.

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